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CASES  
ON  
THE GENERAL PRINCIPLES  
OF THE  
LAW OF  
PRIVATE CORPORATIONS

SELECTED AND ARRANGED WITH NOTES

BY  
HORACE L. WILGUS, M. SC.

Professor of Law in the University of Michigan

IN TWO VOLUMES  
VOLUME II

"A substantial and compendious report of a case rightly adjudged doth produce three notable effects; *first*, It openeth the understanding of the reader and hearer; *secondly*, it breaketh through difficultes; and *thirdly*, it bringeth home to the hand of the studious, variety of pleasure and profit; I say it doth open the window of the laws, to let in that gladsome light, whereby the right reason of the rule (the beauty of the law) may be clearly discerned; It breaketh the thick and hard shell, whereby with pleasure and ease, the sweetness of the kernel may be sensibly tasted, and adorneth with variety of fruits, both pleasant and profitable, the store-houses of those by whom they were never planted nor watered."

LORD COKE, in Preface to 9th Report.

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## NOTE.

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In the first volume, and in the first two titles of the second volume, are considered the doctrines relating to the birth, life, powers, acts, obligations, and death of a corporation, effort being made to get a view of the general principles as a whole.

This second volume, with the exception of the first two titles, deals with the Corporation as a Subject and Source of Peculiar Rights and Obligations in its twofold aspect of *Corporate Relations* and *Individual Relations*.

The Corporate Relations comprise the relation of the Corporation to the State, including the Creating State, other States, and the National Government; to the promoters; to the officers; to the shareholders; to the creditors, and to others.

The Individual Relations comprise the relations of the various groups of persons—the promoters, the officers, the shareholders, and the creditors, and each member of each group to the other groups or members thereof, as well as the members of each group among themselves.

In most cases these several relations are developed by considering the rights of each as against the others; as, for example, in the Relation of the Corporation to its Shareholders are considered (1) the rights of the corporation as against the shareholders, and (2) the rights of the shareholders as against the corporation; and likewise with the rest, so far as possible; in the Relation of the Corporation to the State, however, it seemed better not to make such a separation.

### TITLE III. THE DOCTRINE OF ULTRA VIRES.<sup>1</sup>

#### CHAPTER 14.

#### GENERAL THEORY OF ULTRA VIRES TRANSACTIONS.

##### ARTICLE I. MEANING OF THE TERM.

##### Sec. 357.

DEPUE, J., IN CAMDEN AND ATLANTIC R. R. CO. v. MAY'S LAND-  
ING, ETC., R. R. CO.

1886. IN THE COURT OF ERROR AND APPEALS OF NEW JERSEY.  
48 N. J. L. Rep. 530, on 574-575.

The expression *ultra vires* is used in different senses—to express either that the act of the directors or officers is in excess of their authority as agents of the corporation, or that the act of the majority of the stockholders is in violation of the rights of the minority, or that the act has not been done in conformity with requirements of the charter, or that the act is one that the corporation itself has not the capacity to do, as being in excess of its corporate powers.

The indiscriminate use of this expression, with respect to cases different in their nature and principles, has led to considerable confusion, if not misapprehension. Where the act done by directors or officers is simply beyond the powers of the executive department of the corporation as the agency by which the corporation exercises its functions, and not of the corporation itself, it may be made valid and binding by the action of the board of directors, or by the approval of the stockholders. Where the act done by stockholders is not in excess of the powers of the corporation itself, but is simply an infringement upon the rights of other stockholders, it may be made binding upon the latter by ratification or by consent implied from acquiescence. Where the infirmity of the act does not consist in a want of corporate power to do it, but in the disregard of formalities prescribed, it may

<sup>1</sup> Note. See on the general subject of *ultra vires*: Abbott's Digest, p. 870; 27 Am. & Eng. Ency. 351; Angell & Ames, § 256; 2 Beach, §§ 421-439; Boone, §§ 98-104; 12 Century Digest, §§ 1545-1547; Clark, §§ 62-68; Cook, §§ 3, 667-683; Elliott, §§ 200-230; 12 Ency. Laws of England, p. 360; Green's Brice's Ultra Vires; 2 Potter, §§ 540-561; 2 Morawetz, §§ 575-724; Reese Ultra Vires; 2 Spelling, §§ 758-769; Taylor, §§ 264-338; 4 Thompson, §§ 5638-5652; 5 Thompson, §§ 5967-6042; 7 Thompson, §§ 8308-8331; 1 Waterman, §§ 160-161.

or may not be valid as to third persons dealing *bona fide* with the corporation, according to the nature of the formality not observed, or the consequences the legislature has imposed upon non-observance. These are all cases depending upon legal principles, not peculiarly applicable to corporations, and the use of the phrase *ultra vires* tends to confusion and misapprehension. In its legitimate use, the expression *ultra vires* should be applied only to such acts as are beyond the powers of the corporation itself. In this sense it is to be applied in this case.

In the discussion of this subject a distinction is sometimes taken between the acts of a corporation, which it is not expressly, or by necessary implication, empowered to do, and acts expressly forbidden it to do, treating the latter as incapable of being endowed with any validity, and the former as susceptible of ratification, and capable of obtaining validity from equitable estoppel.

See, also, 1869, *Miner's Ditch Co. v. Zellerbach*, 37 Cal. 543, 99 Am. Dec. 300, *infra*, p. 1200; 1899, *National, etc., Loan Ass'n v. Home Sav. Bank*, 181 Ill. 35, 72 Am. St. Rep. 245.

Also, *note*, 70 Am. St. Rep. 156.

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#### ARTICLE II. THEORIES AS TO UNDERLYING PRINCIPLES.

**Sec. 358.** (1) *Ultra vires* acts void because of legal incapacity to make them.

**MR. JUSTICE BREWER IN CHICAGO, R. I. & P. RY. CO. v. UNION PAC. RY. CO.**

1891. IN THE UNITED STATES CIRCUIT COURT. 47 Fed. Rep. 15, on 20, 21.

The doctrine of *ultra vires* has been thoroughly sifted within the last thirty years—its extent and limitations clearly defined. *Thomas v. Railroad Co.*, 101 U. S. 71; *Branch v. Jesup*, 106 U. S. 468, 1 Sup. Ct. Rep. 495; *Pennsylvania R. Co. v. St. Louis, A. & T. H. R. Co.*, 118 U. S. 290, 6 Sup. Ct. Rep. 1094; *Oregon Ry. & Nav. Co. v. Oregonian Ry. Co.*, 130 U. S. 1, 9 Sup. Ct. Rep. 409; *Central Transp. Co. v. Pullman's Palace Car Co.*, 139 U. S. 24, 11 Sup. Ct. Rep. 478. Two propositions are settled. One is that a contract by which a corporation disables itself from performing the functions and duties undertaken and imposed by its charter is, unless the state which created it consents, *ultra vires*. A charter not only grants rights—it also imposes duties. An acceptance of those rights is an assumption of those duties. As it is a contract which binds the state not to interfere with those rights, so, likewise, it is one which binds the corporation not to abandon the discharge of those duties. It is not like a deed or patent, which vests in the grantee or patentee, not only title, but full power of alienation; but it is more—it is a con-



tract whose obligations neither party, state or corporation, can, without the consent of the other, abandon. The other is that the powers of a corporation are such, and such only, as its charter confers; and an act beyond the measure of those powers, as either expressly stated or fairly implied, is *ultra vires*. A corporation has no natural or inherent rights or capacities. Created by the state, it has such powers as the state has seen fit to give it—"only this, and nothing more." And so, when it assumes to do that which it has not been empowered by the state to do, its assumption of power is vain; the act is a nullity; the contract is *ultra vires*. These two propositions embrace the whole doctrine of *ultra vires*. They are its alpha and omega.

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**Sec. 359. Same.**

**CENTRAL TRANSPORTATION CO. v. PULLMAN'S PALACE CAR CO.<sup>1</sup>**

1891. IN THE SUPREME COURT OF THE UNITED STATES. 139 U. S. 24, 66, 11 Sup. Ct. 478.

In error to the circuit court of the United States for the eastern district of Pennsylvania.

This was an action of covenant, brought September 21, 1886, by the Central Transportation Company, a corporation of Pennsylvania, against Pullman's Palace Car Company, a corporation of Illinois, to recover the sum of \$198,000, due for the last three-quarters of the year ending July 1, 1886, according to the terms of an indenture of lease from the plaintiff of all its personal property to the defendant, dated February 17, 1870, and set forth in full in the declaration.

Plaintiff was nonsuited in the court below, and then sued out this writ of error.

**MR. JUSTICE GRAY.** The principal defense in this case, duly made by the defendant, by formal plea, as well as by objection to the plaintiff's evidence, and sustained by the circuit court, was that the indenture of lease sued on was void in law, because beyond the powers of each of the corporations by and between whom it was made.

[After disposing of a preliminary question of practice and reviewing the following cases: Railroad Co. v. Winans, 17 How. 30, 39; Pearce v. Railroad Co., 21 How. 441-443; Zabriskie v. Railroad Co., 23 How. 381, 398; Thomas v. Railroad Co., 101 U. S. 71, 80, 81, 82, 85, Branch v. Jesup, 106 U. S. 468, 478, 479, 1 Sup. Ct. Rep. 495; Pennsylvania R. Co. v. St. Louis, etc., R. Co., 118 U. S. 290, 309, 312, 630, 6 Sup. Ct. Rep. 1094, 7 Sup. Ct. Rep. 68, 24; Salt Lake City v. Hollister, 118 U. S. 256, 263, 6 Sup. Ct. Rep. 1055; Willamette Woolen Manuf'g Co. v. Bank of British Columbia, 119 U. S. 191, 7 Sup. Ct. Rep. 187; Green Bay & M. R.

<sup>1</sup> Statement abridged, and quotations from cases omitted.

Co. v. Union Steam-Boat Co., 107 U. S. 98, 2 Sup. Ct. Rep. 221; Pittsburgh, etc., Ry. Co. v. Keokuk & H. Bridge Co., 131 U. S. 371, 384, 9 Sup. Ct. Rep. 770; Oregon Ry., etc., Co. v. Oregonian Ry. Co., 130 U. S. 1, 30, 32, 34, 35, 9 Sup. Ct. Rep. 409, *supra*, p. 429.

The clear result of these decisions may be summed up thus: The charter of a corporation, read in the light of any general laws which are applicable, is the measure of its powers, and the enumeration of those powers implies the exclusion of all others not fairly incidental. All contracts made by a corporation beyond the scope of those powers are unlawful and void, and no action can be maintained upon them in the courts, and this upon three distinct grounds: The obligation of every one contracting with a corporation to take notice of the legal limits of its powers; the interest of the stockholders, not to be subjected to risks which they have never undertaken; and, above all, the interest of the public, that the corporation shall not transcend the powers conferred upon it by law. A corporation can not, without the assent of the legislature, transfer its franchise to another corporation, and abnegate the performance of the duties to the public, imposed upon it by its charter as the consideration for the grant of its franchise. Neither the grant of a franchise to transport passengers, nor a general authority to sell and dispose of property, empowers the grantee, while it continues to exist as a corporation, to sell or to lease its entire property and franchise to another corporation. These principles apply equally to companies incorporated by special charter from the legislature, and to those formed by articles of association under general laws.

By a familiar rule, every public grant of property, or of privileges or franchises, if ambiguous, is to be construed against the grantee, and in favor of the public; because an intention, on the part of the government, to grant to private persons, or to a particular corporation, property or rights in which the whole public is interested, can not be presumed, unless unequivocally expressed or necessarily to be implied in the terms of the grant; and because the grant is supposed to be made at the solicitation of the grantee, and to be drawn up by him or by his agents, and therefore the words used are to be treated as those of the grantee; and this rule of construction is a wholesome safeguard of the interests of the public against any attempt of the grantee, by the insertion of ambiguous language, to take what could not be obtained in clear and express terms. *Charles River Bridge v. Warren Bridge*, 11 Pet. 420, 544-548; *Railroad Co. v. Litchfield*, 23 How. 66, 88, 89; *Slidell v. Grandjean*, 111 U. S. 412, 437, 438, 4 Sup. Ct. Rep. 475. This rule applies with peculiar force to articles of association which are framed under general laws, and which are a substitute for a legislative charter, and assume and define the powers of the corporation by the mere act of the associates, without any supervision of the legislature or of any public authority. *Oregon Ry., etc., Co. v. Oregonian Ry. Co.*, 130 U. S. 26, 27, 9 Sup. Ct. Rep. 413, 414.

[After reviewing the terms of the lease.] \* \* \* The plaintiff not

only parts with all its means of carrying on the business, and of performing the duty for which it had been chartered, of transporting passengers and making and letting cars to transport them in; but it undertakes to transfer, for 99 years, nearly co-extensive with the duration of its own corporate existence, the whole conduct of its business, and the performance of all its public duties, to another corporation; and to continue in existence during that period for no other purpose than that of receiving, from time to time, from the other corporation the stipulated rent or compensation, and of making dividends out of the moneys so received. Considering the long term of the indenture, the perishable nature of the property transferred, the large sums to be paid quarterly by the defendant by way of compensation, its assumption of the plaintiff's debts, and the frank avowal, in the indenture itself, of the intention of the two corporations to prevent competition and to create a monopoly, there can be no doubt that the chief consideration for the sums to be paid by the defendant was the plaintiff's covenant not to engage in the business of manufacturing, using, or hiring sleeping-cars; and that the real purpose of the transaction was, under the guise of a lease of personal property, to transfer to the defendant nearly the whole corporate franchise of the plaintiff, and to continue the plaintiff's existence for the single purpose of receiving compensation for not performing its duties. The necessary conclusion from these premises is that the contract sued on was unlawful and void, because it was beyond the powers conferred upon the plaintiff by the legislature, and because it involved an abandonment by the plaintiff of its duty to the public. \* \* \*

It was argued in behalf of the plaintiff that, even if the contract sued on was void, because *ultra vires* and against public policy, yet that, having been fully performed on the part of the plaintiff, and the benefits of it received by the defendant, for the period covered by the declaration, the defendant was estopped to set up the invalidity of the contract as a defense to this action to recover the compensation agreed on for that period. But this argument, though sustained by decisions in some of the states, finds no support in the judgments of this court.

[Citing and quoting from, to this effect: *Thomas v. Railroad Co.*, 101 U. S. 86; *Ashbury Ry., etc., Co. v. Riche*, L. R. 7 H. L. 653; *Union Trust Co. v. Illinois Midland Ry. Co.*, 117 U. S. 434; *Pennsylvania R. Co. v. St. Louis, etc., R. Co.*, 118 U. S. 316-318; *Salt Lake City v. Hollister*, 118 U. S. 263; *Hitchcock v. Galveston*, 96 U. S. 341, 350; *Louisiana v. Wood*, 102 U. S. 294; *Parkersburg v. Brown*, 106 U. S. 487, 503, 1 Sup. Ct. Rep. 442; *Chapman v. Douglas Co.*, 107 U. S. 348, 355, 2 Sup. Ct. Rep. 62; *Pittsburgh, etc., R. Co. v. Keokuk & H. Bridge Co.*, 131 U. S. 371, 389, 9 Sup. Ct. Rep. 776.]

The view which this court has taken of the question presented by this branch of the case, and the only view which appears to us consistent with legal principles, is as follows: A contract of a corporation, which is *ultra vires*, in the proper sense, that is to say, outside the object of its creation as defined in the law of its organization, and, therefore, beyond the powers conferred upon it by the legislature, is

not voidable only, but wholly void, and of no legal effect. The objection to the contract is not merely that the corporation ought not to have made it, but that it could not make it. The contract can not be ratified by either party, because it could not have been authorized by either. No performance on either side can give the unlawful contract any validity, or be the foundation of any right of action upon it. When a corporation is acting within the general scope of the powers conferred upon it by the legislature, the corporation, as well as persons contracting with it, may be estopped to deny that it has complied with the legal formalities, which are prerequisites to its existence or to its action, because such requisites might in fact have been complied with. But when the contract is beyond the powers conferred upon it by existing laws, neither the corporation, nor the other party to the contract, can be estopped, by assenting to it, or by acting upon it, to show that it was prohibited by those laws. The doctrine of the common law, by which a tenant of real estate is estopped to deny his landlord's title, has never been considered by this court as applicable to leases by railroad corporations of their roads and franchises. It certainly has no bearing upon the question whether this defendant may set up that the lease sued on, which is not of real estate, but of personal property, and which includes, as inseparable from the other property transferred, the inalienable franchise of the plaintiff, is unlawful and void, for want of legal capacity in the plaintiff to make it. A contract *ultra vires* being unlawful and void, not because it is in itself immoral, but because the corporation, by the law of its creation, is incapable of making it, the courts, while refusing to maintain any action upon the unlawful contract, have always striven to do justice between the parties, so far as could be done consistently with adherence to law, by permitting property or money, parted with on the faith of the unlawful contract, to be recovered back, or compensation to be made for it. In such case, however, the action is not maintained upon the unlawful contract, nor according to its terms; but on an implied contract of the defendant to return, or failing to do that, to make compensation for, property or money which it has no right to retain. To maintain such an action is not to affirm, but to disaffirm, the unlawful contract. The ground and the limits of the rule concerning the remedy, in the case of a contract *ultra vires*, which has been partly performed, and under which property has passed, can hardly be summed up better than they were by Mr. Justice Miller in a passage already quoted, where he said that the rule "stands upon the broad ground that the contract itself is void, and that nothing which has been done under it, nor the action of the court, can infuse any vitality into it;" and that, "where the parties have so far acted under such a contract that they can not be restored to their original condition, the court inquires if relief can be given independently of the contract, or whether it will refuse to interfere as the matter stands." *Pennsylvania R. Co. v. St. Louis, etc., R. Co.*, 118 U. S. 317, 6 Sup. Ct. Rep. 1106, 1107. Whether this plaintiff could maintain any action against this defendant, in the nature of a *quantum meruit*, or otherwise, inde-



pendently of the contract, need not be considered, because it is not presented by this record, and has not been argued. This action, according to the declaration and the evidence, was brought and prosecuted for the single purpose of recovering sums which the defendant had agreed to pay by the unlawful contract, and which for the reasons and upon the authorities above stated, the defendant is not liable for.

Judgment affirmed.

Mr. Justice Brown, not having been a member of the court when this case was argued, took no part in its decision.

*Note.* See sequel to this case, 1897, Pullman's Palace Car Co. v. Central Transportation Company, 171 U. S. 138, holding: (1) That the Central Company is entitled to recover from the Pullman Company the value of property transferred by it to that company when the lease took effect, with interest, as that property has substantially disappeared, and can not now be returned; (2) That the value of that property is not to be ascertained from the market value of the shares of the Central Company's stock at that time, but by the value of the property transferred; (3) That the value of the contracts with railroad companies transferred by the Central Company form no part of the sum which it is entitled to recover; (4) That the same principle applies to the patents transferred which had all expired; (5) That it is not entitled to recover anything for the breaking up of its business by reason of the contracts being adjudged illegal.

The United States rule as to leases and the long list of cases supporting it are given in the case given above.

See, *contra*, 1886, Camden & Atlantic R. Co. v. May's Landing, etc., R. Co., 48 N. J. Law 530; 1889, Manchester & L. R. Co. v. Concord R., 66 N. H. 100, 49 Am. St. Rep. 582; 1896, Bath Gas Light Co. v. Claffy, 151 N. Y. 24.

Also *note*, 70 Am. St. Rep. 156, on 163.

As to the general doctrine of *ultra vires* acts being void, because of legal incapacity of the corporation, see note to section 360.

### Sec. 360. Same.

MR. JUSTICE GRAY IN PITTSBURG, C. & ST. L. RY. CO. v. KEOKUK BRIDGE CO.

1889. IN THE SUPREME COURT OF THE UNITED STATES. 131 U. S. 371, on 384-385.

The outlines of the doctrine of *ultra vires*, and the reasons on which it rests, have been clearly stated in previous judgments of this court.

The reasons why a corporation is not liable upon a contract *ultra vires*, that is to say, beyond the powers conferred upon it by the legislature, and varying from the objects of its creation as declared in the law of its organization, are: 1st. The interest of the public, that the corporation shall not transcend the powers granted. 2d. The interest of the stockholders, that the capital shall not be subjected to the risk of enterprises not contemplated by the charter, and therefore not authorized by the stockholders in subscribing for the stock. 3d. The obligation of every one, entering in a contract with a corporation, to take notice of the legal limits of its powers.

These three reasons are clearly brought out in the unanimous judgment of this court, delivered by Mr. Justice Campbell, in the leading case of *Pearce v. Madison and Indianapolis Railroad*, 21 How. 441, in which it was held that a railroad corporation was not liable to be sued upon promissory notes which it had given in payment for a steamboat received and used by it, and running in connection with its railroad.

*Note:* As to the general doctrine of *ultra vires* acts being void because of legal incapacity, see, in addition to the cases cited in *Central Trans. Co. v. Pullman's Pal. Car Co.*, 139 U. S. 24, *supra*, p. 1178; 1804, *Head v. Providence Ins. Co.*, 2 Cranch 127; 1818, *People v. Utica Ins. Co.*, 15 Johns. 358, Am. Dec. 243, *supra*, p. 113; 1824, *New York Firemen Ins. Co. v. Sturges*, 28 Cow. 664; 1827, *Bank of U. S. v. Dandridge*, 12 Wheat. 64; 1829, *Beach v. Fulton Bank*, 3 Wend. 574; 1839, *Bank of Augusta v. Earle*, 13 Pet. 519; 1844, *Barry v. Merchant's Exchange*, 1 Sandf. Ch. 280; 1851, *East Anglian R. Co. v. Eastern Co. R. Co.*, 11 C. B. 775; 1852, *McGregor v. The Deal & Dover R.*, 22 L. J. N. S. Q. B. 69; 1853, *Hood v. The N. Y. & N. H. R. Co.*, 22 Conn. 502; 1855, *Eastern Counties R. Co. v. Hawkes*, 5 H. L. Cas. 331; 1860, *Bissell v. Mich. So. R. Co.*, 22 N. Y. 258, per Selden, J., *infra*, p. 1183; 1863, *Stockport Dist. W. W. v. Mayor, etc.*, 9 Jur. N. S. 266; 1869, *Monument Nat'l Bk. v. Globe Works*, 101 Mass. 57, *supra*, p. 949; 1869, *Miners' Ditch Co. v. Zellerbach*, 37 Cal. 543, 99 Am. Dec. 300; 1872, *Pickering v. Stephenson L. R.*, 14 Eq. Cas. 322, 340; 1875, *Ashbury R. Co. v. Riche*, L. R. 7 H. L. Rep. 653; 1877, *Franklin Co. v. Lewiston Inst. for Sav.*, 68 Maine 43; 1881, *Davis v. Old Colony R. Co.*, 131 Mass. 258, 41 Am. Rep. 221; 1882, *Guinness v. Land Corp.*, 22 Ch. D. 349; 1893, *Marble Co. v. Harvy*, 92 Tenn. 115, 36 Am. St. Rep. 71, 18 L. R. A. 252; 1897, *McCormick v. Market Bank*, 165 U. S. 538; 1897, *California Bank v. Kennedy*, 167 U. S. 362; 1897, *Central Trans. Co. v. Pullman's Pal. Car Co.*, 171 U. S. 138; 1899, *De La Vergne Co. v. German Sav. Inst.*, 175 U. S. 40; 1899, *National Home Bldg. Assn. v. Home Sav. Bk.*, 181 Ill. 35, 72 Am. St. Rep. 245.

*Ultra vires* must be pleaded or it is waived: 1899, *Nat'l Guarantee L. & T. Co. v. Yeatman*, 121 Ala. 594, 25 So. Rep. 1003.

Burden of proving *ultra vires* is on him who alleges it: 1899, *Burden v. Burden*, 159 N. Y. 287; 1899, *West v. Averill Grocery Co.*, 109 Iowa 488, 80 N. W. Rep. 555; 1902, *Allen v. West Point M. Co.*, — Ala. —, 31 So. 462.

Sec. 361. (2) *Ultra vires* acts are not necessarily illegal and void—per Comstock, C. J.

(3) *Ultra vires* acts are illegal and void—per Selden, J.

BISSELL v. THE MICHIGAN SOUTHERN AND NORTHERN INDIANA RAILROAD COMPANIES.<sup>1</sup>

1860. IN THE NEW YORK COURT OF APPEALS. 22 N. Y. 259–309.

COMSTOCK, C. J. A general statement of the plaintiff's case is, that the two corporations defendant were jointly engaged in the business of carrying passengers and freight between Chicago and Lake Erie, through a part of the state of Illinois, and through the states of Indiana and Michigan, by three connected railroads which they owned

<sup>1</sup> Arguments and part of opinions omitted.

or controlled, and the business of which was managed under a consolidated arrangement, which had been in force between the defendants, for some time previous to the injury complained of; that, being so engaged, they undertook and assumed to carry him, the plaintiff, as a passenger, from Chicago, or a point near that place, eastward over the consolidated line of road; that he took his seat in their cars accordingly, and that, during the transit, he was injured by an accident which happened through their carelessness and neglect. Assuming the truth of this statement, there is no doubt of the plaintiff's right to recover.

But the defendants deny the legal truth of these facts, because one of the companies was chartered by the legislature of Michigan, with power to build a road in that state, and the other by the legislature of Indiana, with power to build one in that state. They both insist, that they had no right or power, under their respective charters, to consolidate their business in the manner stated, and especially, that they could not legally, either separately or jointly, acquire the possession and use of a connecting road in the state of Illinois, and undertake to carry passengers or freight over the same. They do not deny that their boards of directors and agents, duly authorized to wield all the powers which the corporations themselves possessed, entered into the arrangements which have been mentioned, nor that, in the execution of those arrangements, they made the contract with the plaintiff to carry him as a passenger; nor do they deny that they received the benefit of that contract, in the customary fare which he paid. Their defense is, simply and purely, that they transcended their own powers, and violated their own organic laws. On this ground, they insist that their business was not, in judgment of law, consolidated; that they did not use and operate a road in Illinois; that they did not undertake to carry the plaintiff over it; and did not, by their negligence, cause the injury of which he complains; but that all these acts and proceedings were, in legal contemplation, the acts and proceedings of the natural persons who were actually engaged in promoting the same.

Can, then, two railroad corporations, having connecting lines, thus unite their business, for the purpose of promoting their common interest; charter another connecting road, in furtherance of the same policy; hold themselves out to the public as carriers over the whole route; enter into contracts accordingly; receive the benefit of those contracts; and then, when liabilities arise, interpose the violation of their own charters to shield them from responsibility? Such a defense is shocking to the moral sense, and although it appears to have some support in judicial opinions, I think it has no foundation in the law.

[Theory of incapacity.]—The doctrine has certainly been asserted on some occasions, that in all cases where the contracts and dealings of a corporation are claimed to be invalid for want of power to enter into the same, a comparison must be instituted between those contracts and dealings and the charter, and, if the charter does not appear to embrace them, then that they must be adjudged void to all intents

and purposes, and in all conceivable circumstances. The reasoning on which this doctrine has been usually claimed to rest, denies, in effect, that corporations can, or ever do, exceed their powers. They are said to be artificial beings, having certain faculties given to them by law, which faculties are limited to the precise purposes and objects of their creation, and can no more be exerted outside of those purposes and objects than the faculties of a natural person can be exerted in the performance of acts which are not within human power. In this view, these artificial existences are cast in so perfect a mold that transgression and wrong become impossible. The acts and dealings of a corporation, done and transacted in its name and behalf, by its board of directors, vested with all its powers, are, unless justified by its charter, according to this reasoning, the acts and dealings of the individuals engaged in them, and for which they alone are responsible. But such, I apprehend, is not the nature of these bodies; like natural persons, they *can overleap the legal and moral restraints imposed upon them: in other words, they are capable of doing wrong*. To say that a corporation has no right to do unauthorized acts, is only to put forth a very plain truism; but to say that such bodies have no power or capacity to err, is to impute to them an excellence which does not belong to any created existences with which we are acquainted. The distinction between power and right is no more to be lost sight of in respect to artificial, than in respect to natural persons. \* \* \*

In the case of *The Life and Fire Insurance Company v. Mechanics' Fire Insurance Company*, 7 Wend. 31, it was contended that a certain corporate transaction, if unlawful, was to be regarded as the act of the agents or officers of the company, and not of the company, and, therefore, that the company should be allowed to recover back the money or property improperly disposed of. That doctrine was refuted by Mr. Justice Sutherland, in this language: "This would be a most convenient distinction for corporations to establish—that every violation of their charter, or assumption of unauthorized power on the part of their officers, although with the full approbation of their directors, is to be considered the act of the officers, and is not to prejudice the corporation itself. There would be no possibility of ever convicting a corporation of exceeding its powers, and thereby forfeiting its charter, or incurring any other penalty, if this principle could be established." These remarks suggest an unanswerable argument against the doctrine. Why, it may be asked, does the law provide the remedy by *quo warranto* against corporations, for usurpation and abuse of power? Is it not the very foundation of that proceeding, that corporations can and do perform acts and usurp franchises beyond the rightful authority conferred by their charters? Most assuredly this is so. The sovereign power of the state interposes, alleges the excess or abuse, and on that ground demands from the courts a sentence of forfeiture. \* \* \*

Corporations are said to be clothed with certain powers enumerated

in their charters, or incidental to those which are enumerated, and it is also said they can not exceed those powers; therefore, it has been urged, that all attempts to do so are simply nugatory. The premises are correct, when properly understood; but the conclusion is false, because the premises are misinterpreted. When we speak of the powers of a corporation, the term only expresses the privileges and franchises which are bestowed in the charter; and when we say it can not exercise other powers, the just meaning of the language is, that as the attempt to do so is without authority of law, the performance of unauthorized acts is a usurpation, which may be a wrong to the state, or, perhaps to the shareholders. But the usurpation is possible. The privileges and franchises granted are not the whole of a corporation. Every trading corporation aggregate includes an association of persons having a collective will, and a board of directors or other agency in which that will is embodied, and through which it may be exerted in modes of action not expressed in the organic law. Thus, like moral and sentient beings, they may and do act in opposition to the intention of their creator, and they ought to be accountable for such acts. \* \* \*

[Theory of illegality.] But the doctrine, that corporations can never be bound by engagements not justified by the grant of power from the state, is next defended on a different ground. Although it be conceded that they are present and acting as legal persons, or entities, when such engagements are entered into, it is said that all contracts in excess of the rightful power possessed by corporations are illegal, and therefore void. This is an argument totally different from the one which has been so far examined, because it necessarily imputes the making of the contract to the corporate person or being; whereas the doctrine which I have endeavored to refute denies that proposition. The very point of the supposed illegality consists, or, at least, it may consist, in the performance of acts perfectly lawful in themselves, but which being done by a corporation and not by individuals, are pronounced illegal, because they are so done without authority contained in the charter.

But is it true that all contracts of corporations for purposes not embraced in their charters are illegal, in the appropriate sense of that term? This proposition I must deny. Undoubtedly, such engagements may have the vices which sometimes infect the contracts of individuals. They may involve a *malum in se* or a *malum prohibitum*, and may be void for any cause which would avoid the contract of a natural person. But where no such vices exist, and the only defect is one of power, the contract can not be void, because it is illegal or immoral. Such a doctrine may have some slight foundation in the earlier English railway cases, *East Anglian Railway Co. v. Eastern Counties Railway Co.*, 11 C. B. 775, 7 Eng. Law. & Eq. 509; *McGregor v. Deal and Dover Railway Co.*, 18 Q. B. 618; but it was never established, and is not now received in the English courts. *Mayor of Norwich v. Norfolk Railway Co.*, 4 El. & Bl. 397; *Eastern Counties Railway Co. v. Hawkes*, 5 H. L. C. 347.

The books are full of cases upon the powers of corporations, and



the effect of dealing in a manner and for objects not intended in their charters; but with the slight exception named, there is an entire absence, not only of adjudged cases, but of even judicial opinion or *dicta*, for the proposition that mere want of authority renders a contract illegal. Such a proposition seems to me absurd; the words *ultra vires* and illegality represent totally different and distinct ideas. It is true, that a contract may have both these defects, but it may also have one without the other. For example, a bank has no authority to engage, and usually does not engage, in benevolent enterprises. A subscription, made by authority of the board of directors and under the corporate seal, for the building of a church or college, or an almshouse, would be clearly *ultra vires*, but it would not be illegal; if every corporator should expressly assent to such an application of the funds, it would still be *ultra vires*, but no wrong would be committed, and no public interest violated. So a manufacturing corporation may purchase ground for a school-house, or a place of worship for the intellectual, religious, and moral improvement of its operatives; it may buy tracts and books of instruction for distribution amongst them. Such dealings are outside of the charter; but, so far from being illegal or wrong they are in themselves benevolent and praiseworthy. So a church corporation may deal in exchange; this, although *ultra vires*, is not illegal, because dealing in exchange is, in itself, a lawful business, and there is no state policy in restraint of that business.

To illustrate the subject in another manner: An agent may make a contract in the name and behalf of his principal, but not within the scope of his agency. If the consideration and purpose of such a contract be lawful, it may be void as against the principal, but not on the ground of illegality. A corporation is not an agent of the state, nor, in any strict sense, of the shareholders. But it derives its powers from the state, and it may transcend those powers for purposes which, in themselves considered, involve no public wrong. Contracts so made may be defective in point of authority, and may contemplate a private wrong to the shareholders; but they are not illegal, because they violate no public interest or policy. My meaning, in short, is that the *illegality* of an act is determined in its quality, and does not depend on the person or being which performs it.

[Underlying reasons and policy—Nature of a corporation.] There has been, I think, some want of reflection, even in judicial minds, upon the reasons and policy which mainly govern in the granting of charters to corporations, with certain specified powers and no others. A private or trading corporation is essentially a chartered partnership, with or without immunity from personal liability beyond the capital invested, and with certain other convenient attributes which ordinary partnerships do not enjoy. It is also something more than a partnership, because the legal or artificial person becomes vested with the title to all the estate and capital contributed, to be held and used, however, in trust for the shareholders. Now, in a well-regulated unincorporated partnership, the articles entered into by the associates specify the objects of their association. But, suppose the same associates

desire a charter of incorporation for the more convenient prosecution of the same business, and obtain one. We shall find it to contain the like specification, which becomes the grant of power from the sovereign authority of the state. I am speaking of powers and privileges granted which are not, in their essential nature, corporate or public franchises, as distinguished from the private enterprises which any class of citizens may embark in; and, with the exception of municipal or governmental charters, the class of powers here referred to will be found to cover nearly the whole field of corporate rights. It is not difficult, then, to see the reason and policy which underlie such grants. The associates ask for a charter, in order to carry on their business with greater advantages; and the same reason exists for a specification of the purposes of their organization, as in the case of an association without a charter. The charter takes the place of the articles of agreement, and becomes the appropriate rule of action. No public interest or policy is involved, because the objects of the grant are not of a public nature; the powers and rights specified are identical with those which any private person or association of persons may exercise. If those who manage the concerns of a simple partnership deal with the funds in a manner or for purposes not specified, their acts are *ultra vires*; and if the directors of such corporation as I am here speaking of do the same thing, their acts are also *ultra vires* in the same sense and no other. To apply the word "illegality" to such transactions, is to confound things of a totally different nature. It is only private interests which are affected by them; and there is no statute or rule of the common law by which they become public offenses.

In every treatise upon the law of contracts—and there are many of them—we shall find an enumeration of such as are immoral or illegal; but amongst them can not be found a specification of the promise or agreement of a corporation, founded on a lawful consideration, and to do that which in itself is lawful to be done, although not within the powers granted. It has always been supposed, and to that effect are all the authorities, that contracts are illegal either in respect to the consideration or the promise. Where both of these are lawful and right, the maxim, "*ex turpi contractu non oritur actio*," can have no application. The incapacity of the contracting party, whether it be a corporation, an infant, a *feme covert*, or a lunatic, has nothing to do with the legality of the contract, in that sense of the word which is now under discussion. So, in the treatises upon corporations, we shall find their rights and privileges to be very extensively considered, but nowhere an intimation that their dealings outside of their charters are deemed illegal for that cause. \* \* \*

[Estoppel.] Let us now concede that the unauthorized contracts of a corporation are illegal in the sense contended for; it by no means follows that they are never to be enforced. An agreement declared by statute to be void can not be enforced, because such is the legislative will; but when, without any such declaration, it is simply illegal, it is capable of enforcement, where justice plainly requires it. Circum-

stances may, and often do, exist, which estop the offender from taking advantage of his own wrong. The contract may be entered into on the other side, without any participation in the guilt, and without any knowledge even of the vice which contaminates it. An innocent person may part with value, or otherwise change his situation, upon the faith of the contract. A railroad corporation, for example, may purchase iron rails, and give its obligation to pay for them, with a design to sell them again on speculation, instead of using them for continuing its track; such a transaction is clearly unauthorized, and is, therefore, said to be illegal. But if the corporation is deemed to make the contract—in other words, if, as I have above shown, it is a legal possibility for corporations to make contracts outside of their just powers, how can its illegality be set up against the other party, who knows nothing of the unlawful purpose? So, an incorporated bank may purchase land, having power to do so for a banking-house, but actually intending to speculate in the transaction. This is also *ultra vires*; but can the want of authority be interposed, in repudiation of a just obligation to pay for the same land, the vendor not being *in pari delicto*? Such a doctrine is not only shocking to the reason and conscience of mankind, but it goes far beyond the law in regard to the illegal contracts of private individuals.

As I am not contending that the unauthorized dealings of a corporation are never to be questioned, the object of this discussion has been to ascertain the true ground on which they can be impeached, where they are not attended by the vices which are fatal to private contracts also. I have shown, I trust—1. That such dealings are possible in law, as they often take place in fact; in other words, that it is in the nature of these bodies to overleap the restraints imposed upon them. 2. That a transgression of this nature is a simple excess of power (using that word to express the rules of action prescribed in their charters, and by which they ought to regulate their conduct), but is not tainted with illegality, so as to avoid the contract or dealing, on that ground. This proposition, it seems hardly necessary to repeat, is applied only to transactions which involve or contemplate no violation of the code of public or criminal law, but on the contrary, are innocent and lawful in themselves. 3. Even illegal contracts, in the proper sense, are not, universally and indiscriminately, to be adjudged void; and especially this is not so where the offender alleges his own wrong to avoid just responsibility, the other party being innocent of the offense.

If these negative conclusions can not be denied, it follows, that contracts and dealings such as I have been speaking of, are to be condemned by the courts only on the ground that they are a breach of the duty which private corporations owe to the stockholders to whom the capital beneficially belongs. It is the undoubted right of stockholders to complain of any diversion of the corporate funds to purposes unauthorized in the charter. This, as a general principle, can not be too strongly asserted; and by this principle, justly applied to particular instances, the question in such cases is to be resolved. The original



subscribers contribute the capital invested, and they and those who succeed to their shares are always, in equity, the owners of that capital. But, legally, the ownership is vested in the corporate body, impressed with the trusts and duties prescribed in the charter; in these relations we have the only true foundation of the plea of *ultra vires*. \* \* \*

It is also said, in order to render this doctrine less offensive to the reason and conscience, that the innocent dealer may, upon the voidness of the contract and a disaffirmance of it, recover back the value or consideration with which he has parted. This position necessarily concedes that the corporation, as a legal person, made the unauthorized contract, and received the money, or value, under and according to it; thus overthrowing the main objection to its liability to respond directly upon the contract. It also concedes the innocence of the other contracting party; thus, according to all the analogies of the law, refuting the only other objection (illegality) on which the absolute invalidity of such dealings is claimed to rest: for, surely, after conceding that the corporation actually made the contract, it will not be contended that it can set up that it ought not to have made it against an innocent person, who has given up his money or property on the faith of the same contract. But I answer, further, that while in many cases the remedy of a suit in disaffirmance of the agreement, and to recover back the consideration, will be sufficient to prevent wrong, in many others it will be entirely worthless. All collateral securities must fall to the ground with the principal contract, and all its consequences and results. The present case will afford the best illustration. The defendants, in consideration of a trifling sum received from the plaintiff for fare, agreed to perform the service of carrying him in their cars, perhaps some two hundred miles. By the negligent performance of that agreement, they inflicted on him injuries for which a jury has said the proper compensation was \$2,500. This being the measure of damages for the breach of the contract, the absurdity, not less than the injustice, of confining him to the remedy of disaffirmance, because the agreement was *ultra vires*, must be quite apparent. \* \* \*

But little more need be said in reference to the particular case now before us. If the defendants did not become liable for the breach of their undertaking to carry the plaintiff, or of their duty resulting from that undertaking, I can see no ground for holding them accountable as simple wrong-doers. If their contract was *ultra vires*, and that defense to an action upon it must be received as absolute and peremptory,—if no principle of estoppel or rule of justice can be urged against that defense,—then it is more clear, that the simple wrong to the plaintiff's person was also *ultra vires*. It was with considerable difficulty that the liability of a corporation in any case for a pure tort was ever established: and they are never so liable, except when engaged in the performance of some duty or undertaking in respect to which accountability arises. If the defendants' express undertaking was absolutely void, so that no duty could arise thereupon, the implied

undertaking, resulting from the actual attempt to carry the plaintiff as a passenger, is encountered by the same objection; and there is nothing left of the transaction except a pure and simple tort, committed by the defendants' servants, while not engaged in any business which could bring responsibilities upon the defendants themselves. I think it plain that this theory of liability will not sustain the plaintiff's case.

But I have no hesitation in affirming the judgment of the court below, upon the principles of contract, and of duty resulting therefrom. \* \* \*

SELDEN, J. \* \* \* When a corporation, sued for a breach of contract, sets up as a defense its own want of power to enter into the contract, two questions are involved: First, whether the contract was, in truth, beyond the corporate powers; and, second, if so, whether this is available as a defense. It is only in reference to the first of these questions, and to prove that the contract was really *ultra vires*, that the argument has been resorted to, that a corporation has no natural powers. The excess of power being established, the question, whether this constitutes a valid defense, depends upon entirely different considerations.

The assumption, therefore, that the doctrine, which declares the unauthorized contract of a corporation to be void, rests in any degree upon the theory that a corporation can never be said to have done anything but what it had a legitimate right to do, is wholly unwarranted; and, hence, the irresistible logic with which it is shown that corporations must necessarily partake of the imperfection which attaches to all created things, is wholly without force in its application to the present case. Corporations, as well as natural persons, may, no doubt, err. They may exceed their powers and violate their charters, and may be held responsible for so doing. Were it otherwise, they could never be made liable for a tort; nor could they be proceeded against by *quo warranto*. The statute which authorizes the attorney-general to file an information in the nature of a *quo warranto* against an offending corporation (2 R. S. 583, § 39), assumes that corporations may transgress the limits prescribed by their charters. Subdivision 5 of the section referred to provides that the proceeding may be instituted "whenever it (the corporation) shall exercise any franchise or privilege not conferred upon it by law."

[True theory of *ultra vires* is illegality, as violating public policy.] The real ground upon which the defense of *ultra vires* rests, and the only one upon which it has ever, to any extent, been judicially based, is, that the contracts of corporations which are unauthorized by their charters are to be regarded as illegal, and, therefore, void. There are three classes of illegal contracts, viz.: 1st, those which are *mala in se*, i. e., which embrace something which the law deems in and of itself criminal or immoral; 2d, those which violate the provisions of some statute, and are hence called *mala prohibita*; and, 3d, those which contravene some principle of public policy. Corporations may make contracts falling within either of the two first of these

classes, and such contracts are no doubt subject to the same rules as if made by individuals. Of course, where the only objection to the contract of a corporation is that it exceeds the corporate powers, it can not be considered as *malum in se*; and although, in this state, where we have a statute (1 R. S. 600, § 3), expressly enacting that no corporation shall exercise any corporate powers except such as their charters confer, the contrary might, with much plausibility, be contended. I shall, nevertheless, concede, for the purposes of this case, that such contracts do not belong to the class styled *mala prohibita*.

But the contracts of corporations which are not authorized by their charters are illegal, because they are made in contravention of public policy. That contracts which do in reality contravene any principle of public policy are illegal and void, is not and can not be denied. The doctrine is universal. There is no exception. Although the unauthorized contract may be neither *malum in se* nor *malum prohibitum*, but, on the contrary, may be for some benevolent or worthy object, as to build an alms-house or a college, or to purchase and distribute tracts or books of instruction, yet, if it is a violation of public policy for corporations to exercise powers which have never been granted to them, such contracts, notwithstanding their praiseworthy nature, are illegal and void. Those, therefore, who hold that corporations are liable upon their contracts, notwithstanding they were made without authority, are forced to contend that no principle of public policy is violated by such contracts. This is the ground which they do take, and which, it is obvious, they must necessarily take, in order to sustain their position. Here, then, we have an issue made up, which, if I am right, is decisive of the question under consideration.

[Public policy involved.] What, then, is the argument, by which it is sought to be shown that there is no principle of public policy involved in this question of the liability of corporations for their unauthorized acts? It is said that a private corporation is simply a chartered partnership, possessing certain attributes conferred by its charter for the purpose of enabling it the more conveniently to transact its business; that, even in unincorporated partnerships, the articles of co-partnership always specify the objects of the association; and that, when such associations choose to become incorporated, those objects are, for the same reason, specified in the charter; that the charter simply takes the place in this respect of the articles of agreement, in the case of an unincorporated partnership; that, as the objects of such associations, although incorporated, are of a private nature, there is no question of public policy involved, and that no public interest requires that the transactions of the corporation should be kept within its chartered limits.

If we admit the soundness of this argument, and assume that the directors of a corporation are not under any public obligation to keep within their chartered powers, but are to be regarded simply as the agents of the corporators, so that any excess of power on their part amounts simply to a breach of trust towards their principals, it would not follow that the corporation is liable upon its unauthorized con-

tracts. But I apprehend there are serious objections to this view of the nature of corporations, and of the effect of their charters. In the first place, if there is no public interest involved, how is it possible to justify the creation of private corporations at all? Such corporations are endowed with valuable franchises and privileges, which give them great advantages over mere private citizens, whether individual or associated. The grant of such privileges, upon the principles for which some of my associates contend, would be a pure piece of legislative favoritism, which should be indignantly condemned. In this country, if in no other, it is held to be the duty of government to protect the people in the enjoyment of *equal* rights and privileges, and not to use its power for the special benefit of its favorites. Every privilege or advantage given to one man or set of men is necessarily at the expense of others; and it is against the fundamental principles of our government that this should be done, unless required by interests of a public nature. No doubt these principles are frequently violated, and corporate powers and privileges are conferred which no public interest demands; but, nevertheless, such interest is the ostensible reason for the grant in every case.

Take, for instance, the very class of corporations in question here, viz., railroad corporations, which are mere private associations, organized by their members with a view to their personal profit and emolument; and yet their creation is considered so much a matter of public interest as to invoke the power of eminent domain, by which the property necessary for their purposes is forcibly taken from its owners as for a public use. The same is true of telegraph and plank-road incorporations. But, although the interest of the public in the creation of corporations of this class is made a little more obvious by the necessity which exists of taking from others property which is specific and tangible, for the purposes of the corporation, yet the same principle applies to all corporations; for in all some value, corporeal or incorporeal, is taken from a portion of the community and given to the corporators.

Will it be said that, although the public have an interest in the creation of corporations, it has none in the precise extent of the powers conferred, and that no public policy is concerned in their being strictly confined to the exercise of such powers? It is, obviously, impossible to support such a position. The franchises and privileges given to corporations belong to the public, and it would be just as reasonable, and just as logical, to contend that, under a patent for one hundred acres of land, the patentee might take possession of two hundred without infringing any public interest. Every additional power given to, or usurped by, a corporation, extends its advantages over persons unincorporated. If a bank is permitted to trade in merchandise it comes in competition with others so employed. If a railroad company is allowed to build and sail ships, it comes in competition with those engaged in commerce, and so of every other branch of business.

The importance of limiting corporate bodies to the exercise of those

classes, and such contracts are no doubt subject to the same rules as if made by individuals. Of course, where the only objection to the contract of a corporation is that it exceeds the corporate powers, it can not be considered as *malum in se*; and although, in this state, where we have a statute (1 R. S. 600, § 3), expressly enacting that no corporation shall exercise any corporate powers except such as their charters confer, the contrary might, with much plausibility, be contended. I shall, nevertheless, concede, for the purposes of this case, that such contracts do not belong to the class styled *mala prohibita*.

But the contracts of corporations which are not authorized by their charters are illegal, because they are made in contravention of public policy. That contracts which do in reality contravene any principle of public policy are illegal and void, is not and can not be denied. The doctrine is universal. There is no exception. Although the unauthorized contract may be neither *malum in se* nor *malum prohibitum*, but, on the contrary, may be for some benevolent or worthy object, as to build an alms-house or a college, or to purchase and distribute tracts or books of instruction, yet, if it is a violation of public policy for corporations to exercise powers which have never been granted to them, such contracts, notwithstanding their praiseworthy nature, are illegal and void. Those, therefore, who hold that corporations are liable upon their contracts, notwithstanding they were made without authority, are forced to contend that no principle of public policy is violated by such contracts. This is the ground which they do take, and which, it is obvious, they must necessarily take, in order to sustain their position. Here, then, we have an issue made up, which, if I am right, is decisive of the question under consideration.

[Public policy involved.] What, then, is the argument, by which it is sought to be shown that there is no principle of public policy involved in this question of the liability of corporations for their unauthorized acts? It is said that a private corporation is simply a chartered partnership, possessing certain attributes conferred by its charter for the purpose of enabling it the more conveniently to transact its business; that, even in unincorporated partnerships, the articles of co-partnership always specify the objects of the association; and that, when such associations choose to become incorporated, those objects are, for the same reason, specified in the charter; that the charter simply takes the place in this respect of the articles of agreement, in the case of an unincorporated partnership; that, as the objects of such associations, although incorporated, are of a private nature, there is no question of public policy involved, and that no public interest requires that the transactions of the corporation should be kept within its chartered limits.

If we admit the soundness of this argument, and assume that the directors of a corporation are not under any public obligation to keep within their chartered powers, but are to be regarded simply as the agents of the corporators, so that any excess of power on their part amounts simply to a breach of trust towards their principals, it would not follow that the corporation is liable upon its unauthorized con-



tracts. But I apprehend there are serious objections to this view of the nature of corporations, and of the effect of their charters. In the first place, if there is no public interest involved, how is it possible to justify the creation of private corporations at all? Such corporations are endowed with valuable franchises and privileges, which give them great advantages over mere private citizens, whether individual or associated. The grant of such privileges, upon the principles for which some of my associates contend, would be a pure piece of legislative favoritism, which should be indignantly condemned. In this country, if in no other, it is held to be the duty of government to protect the people in the enjoyment of *equal* rights and privileges, and not to use its power for the special benefit of its favorites. Every privilege or advantage given to one man or set of men is necessarily at the expense of others; and it is against the fundamental principles of our government that this should be done, unless required by interests of a public nature. No doubt these principles are frequently violated, and corporate powers and privileges are conferred which no public interest demands; but, nevertheless, such interest is the ostensible reason for the grant in every case.

Take, for instance, the very class of corporations in question here, viz., railroad corporations, which are mere private associations, organized by their members with a view to their personal profit and emolument; and yet their creation is considered so much a matter of public interest as to invoke the power of eminent domain, by which the property necessary for their purposes is forcibly taken from its owners as for a public use. The same is true of telegraph and plank-road incorporations. But, although the interest of the public in the creation of corporations of this class is made a little more obvious by the necessity which exists of taking from others property which is specific and tangible, for the purposes of the corporation, yet the same principle applies to all corporations; for in all some value, corporeal or incorporeal, is taken from a portion of the community and given to the corporators.

Will it be said that, although the public have an interest in the creation of corporations, it has none in the precise extent of the powers conferred, and that no public policy is concerned in their being strictly confined to the exercise of such powers? It is, obviously, impossible to support such a position. The franchises and privileges given to corporations belong to the public and it would be just as reasonable, and just as logical, to contend that, under a patent for one hundred acres of land, the patentee might take possession of two hundred without infringing any public interest. Every additional power given to or usurped by, a corporation, extends its advantages over persons unincorporated. If a bank is permitted to trade in merchandise it comes in competition with others so employed. If a railroad company is allowed to build and sail ships, it comes in competition with those engaged in commerce, and so of every other branch of business.

The importance of limiting corporate bodies to the exercise of those

powers, and the enjoyment of those privileges and franchises, which have been specifically conferred upon them, must, I think, be obvious. They are rapidly multiplying. Their privileges give them decided advantages over mere private, unincorporated partnerships. They have large capitals and numerous agents, and are capable of entering into combinations with each other. They are not only formidable to individuals, but might even, under some circumstances, become formidable to the state. They are, or should be, created, as we have seen, for public reasons alone; and the legislature is presumed, in every instance, to have carefully considered the public interest, and to have granted just so much power, and so many peculiar privileges as those interests are supposed to require. This reasoning is confirmed by the action of the legislature, in expressly prohibiting corporations from exercising any powers not granted to them. (1 R. S. 600, § 3, *supra*.) By making this principle of the common law the subject of an express and positive enactment, the legislature has shown that it considered this restriction upon corporations to be a matter of public interest and importance.

The fact that a mere excess of power on the part of a corporation, by the assumption of privileges not conferred, affords ground for a *quo warranto*, is in itself proof that the public has an interest in keeping such bodies within the limits of their charters. \* \* \*

If we consider the directors merely as the agents of the shareholders, and the charter as nothing more than their power of attorney from the corporators, the latter, as the principals, would have a right to repudiate and prevent the execution of a contract, made in their behalf by their agents, without authority; inasmuch as every person dealing with such agents must, as is well settled, be presumed to know the extent of the powers which the charter confers.

The position then occupied by some of my associates is this: They admit that the shareholders in a corporation have a right to restrain its directors or managers, as their trustees or agents, from entering into any contract not authorized by the charter, or from carrying such contract into effect if made; and yet they hold that the directors are liable, not in their individual, but their corporate character, to the party with whom the contract is made for not carrying it into effect. It is difficult to see how these two propositions can stand together. The directors are the mere representatives of the corporators. The latter constitute the corporation. Hence, by the two propositions just stated, it is maintained, that the corporators have a legal right to enjoin their representatives against the performance of a contract, which they themselves are legally bound to perform; in other words, they are liable for damages, because their representatives have not performed a contract, which they had a right to restrain those representatives from performing. This can hardly be. It would seem to be a legal impossibility. One or the other of these propositions must, I think, be false. Either it must be denied that the shareholders can invoke the aid of a court of equity to prevent the performance of a contract entered into by the directors, which the charter does not au-

thorize—a principle established by numerous authorities—or it must be admitted that they are not liable for the refusal or neglect of the directors to perform it. It might be otherwise if it could be shown either that persons dealing with corporations are not presumed to know the extent of the powers conferred by the charter, or that the corporators can be presumed to have authorized the directors to transcend those powers. But the contrary is the rule in respect to both.

It would seem to follow that if we look upon the unauthorized contracts of corporate officers as mere breaches of trust, and nothing more, the corporation is not bound by them. This, however, is not the ground upon which I have been endeavoring to maintain that corporations are exempt from liability upon their contracts which are *ultra vires*; nor is it the ground upon which such defenses have in general been sustained in suits brought by third persons against corporations upon such contracts. I shall, therefore, proceed further to show from the authorities that such contracts are illegal and void for public reasons, entirely irrespective of the fact that they constitute breaches of trust towards the shareholders. [Reviewing cases.] \* \* \*

The strength of the opposing views consists in the alleged injustice of permitting a corporation to avoid obligations by pleading its own want of power to incur them. But it should be remembered that this argument is just as applicable to the case of an individual who sets up the illegality of his own contract, and thus shields himself from the responsibility upon it, as to that of a corporation. If it be said, that in the case of illegal contracts between individuals, each party is a participator in the guilt, and hence the law will not interpose to protect either, this is equally true in respect to the unauthorized contracts of corporations. Their powers are prescribed by statute, and every one who deals with them is presumed to know the extent of these powers. \* \* \*

My conclusion, therefore, is, that the contract of the defendants to transport the plaintiffs from Chicago to Toledo was illegal and void, they having, as we have seen, no power under their charters to enter into the engagement for running their cars on joint account between those two places. It does not follow, however, that they are not liable to the plaintiff in this action. The complaint is founded upon the duty which rested upon the defendants, growing out of the relation in which they stood to the plaintiff, to take care that he should not be injured by their negligence. If this duty could only arise out of some contract between the parties, then the conclusion arrived at would be fatal to the recovery. The contract actually made by the defendants to transport the plaintiff can form no part of the plaintiff's case, and he must recover, if at all, irrespective of that contract.

It is said that if the contract was *ultra vires* and the corporation is protected from all responsibility for its violation on that ground, it must be equally free from responsibility for an injury inflicted while attempting to perform it. But this, I apprehend, by no means follows, though it is probably true so far as the duty to observe due care grew out of the contract. The plaintiff's claim, however, rests not upon



his contract, but upon the right which every man has to be protected from injury through the carelessness of others. It has the same legal foundation as that of one who has been injured by the negligent driving of some person upon the public highway, or who has been run over by a train of cars, when crossing the railroad track. The duty to observe care in these cases arises, not upon any contract, but from the obligation which rests upon all persons, whether natural or artificial, so to conduct as not, through their negligence, to inflict injury upon others. \* \* \*

To test the liability of the defendants, therefore, in this case, it is necessary to inquire what would be the responsibility of railroad companies in general towards persons sitting in their cars, but whom they have made no contract to transport. This must depend upon the circumstances under which the individuals had entered the cars. If they were there as mere trespassers, without shadow of right, the company would not, perhaps, be responsible for any injury they might sustain through the negligence of its servants. But if, on the other hand, the entry into and remaining in the cars was with the assent, express or implied, of the company, and injury should result from the negligence of the latter or its agents, the company would, I think, be responsible. \* \* \*

Was the plaintiff, then, in the defendants' cars as a mere trespasser, or was he there lawfully, as between him and the defendants? To this question there can be but one answer. The defendants can never allege that the plaintiff was in their cars as a trespasser, when he was there by their express assent. The contract between him and the company, it is true, for reasons of policy could not be enforced. The defendants might at any time have repudiated it, and required the defendant to leave the cars; and if he refused might thereafter have treated him as a trespasser. But neither his entry into the cars, nor his remaining there until required to leave, could ever be regarded by the defendants as an infringement upon their legal rights. \* \* \*

*Affirmed.*

Clerke, J., concurred with Selden, J.; Denis, J., for reversal; all other judges for affirmance, without passing upon questions discussed by Comstock, C. J., and Selden, J.

*Note.* See note, 70 Am. St. Rep. 156.

That *ultra vires* acts are not illegal and void, see, 1821, *Utica Ins. Co. v. Scott*, 19 Johns. 1; 1860, *Parish v. Wheeler*, 22 N. Y. 494; 1870, *Bradley v. Ballard*, 55 Ill. 413, 8 Am. Rep. 656; 1875, *Whitney Arms Co. v. Barlow*, etc., 63 N. Y. 62, 20 Am. Rep. 504; 1880, *Pratt v. Short*, 79 N. Y. 437; 1886, *Garrett v. Burlington Plow Co.*, 70 Iowa 697, 59 Am. Rep. 461; 1889, *Wright v. Hughes*, 119 Ind. 324, 40 Am. St. Rep. 69; 1889, *Manchester*, etc., *R. Co. v. Concord*, etc., *R. Corp.*, 66 N. H. 100, 49 Am. St. Rep. 582; 1890, *Sherman Center Town Co. v. Morris*, 43 Kan. 282, 19 Am. St. Rep. 134; 1891, *Horton & Co. v. Long*, 2 Wash. 435, 26 Am. St. Rep. 867; 1891, *Holmes*, etc., *Mfg. Co. v. Holmes Co.*, 127 N. Y. 252, 24 Am. St. Rep. 448; 1892, *Carson City Sav. Bk. v. Carson City El. Co.*, 90 Mich. 550, 30 Am. St. Rep. 454; 1893, *Linkauf v. Lombard*, 137 N. Y. 417, 33 Am. St. Rep. 743; 1894, *Kennedy v. California Bank*, 101 Cal. 495, 40 Am. St. Rep. 69; 1894, *Williams v. Bank*, 71 Miss. 858, 42 Am. St. Rep. 503;

1894, *Kadish v. Garden City, etc.*, Bldg. Ass'n, 151 Ill. 531, 42 Am. St. Rep. 256; 1896, *Bath Gas L. Co. v. Claffy*, 151 N. Y. 24; 1897, *Bedford Belt Co. v. McDonald*, 17 Ind. App. 492, 60 Am. St. Rep. 172; 1897, *Boyd v. Am. Carbon, etc., Co.*, 182 Pa. St. 206; 1899, *Zinc Carbonate Co. v. First Nat'l Bk.*, 103 Wis. 125, 74 Am. St. Rep. 845; 1902, *Vought v. Eastern Bldg., etc., Assn.*, 172 N. Y. 508, 92 Am. St. R. 761.

**Sec. 362.** (4) *Ultra vires* acts are valid if all the shareholders consent, and creditors are not injured.

See *Murphy v. Arkansas & L. L., etc., Co.*, 97 Fed. Rep. 723, *supra*, p. 950.

*Note.* See, 1886, *Swift v. Smith*, 65 Md. 428; 1889, *Arkansas R. L. T., etc., Co. v. Farmers' L. & T. Co.*, 13 Colo. 587; 1890, *Martin v. Niagara Falls, etc., Co.*, 122 N. Y. 165; 1893, *Millsaps v. Merchants' & P. Bank*, 71 Miss. 361; 1894, *People v. Barker*, 141 N. Y. 251; 1895, *Osborn v. Montelac Park*, 153 N. Y. 672, and many other cases given in 1 Cook Corp., § 3.

*Contra*, 1851, *East Anglian R. Co. v. Eastern Counties R. Co.*, 11 C. B. 775; 1875, *Ashbury R. Co. v. Riche*, L. R. 7 H. L. Rep. 653; 1895, *Charlebois v. Delap*, 26 Can. S. C. 221, 238; 1896, *McCutcheon v. Merz Capsule Co.*, 37 U. S. App. 586; 1896, *Germania Safety Vault & T. Co. v. Boynton*, 71 Fed. Rep. 797.

**Sec. 363.** (5) *Ultra vires* acts are valid, except as against the state.

**FARWELL COMPANY v. WOLF.<sup>1</sup>**

1897. IN THE SUPREME COURT OF WISCONSIN. 96 Wis. Rep. 10-22, 65 Am. St. Rep. 22.

[Action to recover damages for a conspiracy to defraud. In 1893 defendants entered into a conspiracy to defraud wholesale dealers in goods, wares and merchandise by purchasing goods on credit, without intending to pay for them, and by having them delivered at the store of one Josephson, who was to sell them and divide the proceeds among the co-conspirators. This scheme was carried out, and large amounts of goods were purchased on credit from the plaintiff and numerous other dealers, who were not paid for their goods. Before the commencement of this action, such dealers, for a valuable consideration, sold and assigned to plaintiff their respective claims for the goods sold, together with their respective causes of action for damages against the defendants on account of such conspiracy. Judgment for plaintiff on all of the claims. Defendants appealed.]

MARSHALL, J. The record shows that plaintiff is a corporation organized for the purpose of carrying on a general dry goods business. The point was raised on the trial, and preserved for review, that it did not possess power to acquire by assignment claims for damages in no way connected with its own affairs, growing out of the alleged con-

<sup>1</sup> Statement as in 65 Am. St. Rep., p. 22; part of opinion omitted.

spiracy to defraud. It does not appear that such claims were in any way necessary to the preservation or enforcement of plaintiff's original claim, or that such purchase was to affect in any way the purposes of its organization, so as to bring its action in that regard within the rules that a corporation may, to preserve its own property and protect its legitimate interests, acquire and enforce liens which would otherwise be outside of the purposes of its organization. A corporation has only such powers as its organic act, charter, or articles of organization confer. This is elementary, but it includes such powers as are reasonably necessary to effect all the general purposes of the corporate creation, though not particularly specified in its charter, unless prohibited thereby, or by some law of the state. From the foregoing, without further discussion, we must hold that plaintiff had no authority to acquire by purchase the various claims for damages on which a recovery was had. But it by no means follows that its want of power can be taken advantage of by the defendants in this action. Formerly, want of corporate power was an effective weapon, both for defense and attack, in the hands of private parties, but, without any change whatever respecting the general doctrine of *ultra vires* as applied to the acts of corporations acting outside the purposes of their creation, there has been a gradual development in the direction of holding that none but a person directly interested in the corporation or the state can question such authority. Such development from the rigorous rule which anciently obtained was manifested earliest in the adoption of the rule that, where a corporation has violated its charter in the purchase and acquirement of real estate, its title thereto and right to enjoy the same can not be inquired into collaterally in actions between private parties, or between the corporation and private parties—that it can be questioned only by the state: *Natoma, etc., Co. v. Clarkin*, 14 Cal. 544; *Alexander v. Tolleston Club*, 110 Ill. 65; *Fritts v. Palmer*, 132 U. S. 282; *Runyan v. Coster*, 14 Pet. 122; *National Bank v. Whitney*, 103 U. S. 99; *Shewalter v. Pirner*, 55 Mo. 218; *Ragan v. McElroy*, 98 Mo. 349; *National Bank v. Matthews*, 98 U. S. 621. In the latter case the supreme court of the United States, reversing the supreme court of the state of Missouri, laid down the rule that, “where a corporation is incompetent by its charter to take a title to real estate, a conveyance to it is not void, but only voidable, and the sovereign alone can object;” that “it is valid until assailed by a direct proceeding instituted for that purpose” by the government; and, further, in effect, that the danger of a judgment of ouster and dissolution is the only check to prevent and punish violations of corporate charters. If the question were respecting the right of a private person to challenge corporate action concerning the acquirement or enjoyment of lands, without authority in the charter so to do, it would be deemed so well settled that no such right exists as not to be open to serious discussion; but whether the same rule governs generally is not so clear.

An extended discussion of the subject, showing the process of development in the application of such a rule, would be interesting and

instructive, but not necessary for the purposes of this opinion. Therefore, we content ourselves with referring to a few well-considered cases, showing the present state of the law respecting the subject, which Thompson, in his work on Corporations, very properly refers to as a "new and growing doctrine." In *Prescott Nat. Bank v. Butler*, 157 Mass. 548, an action between the bank and a private person, the question was raised of whether the action of the former in purchasing notes in the open market as a commodity was *ultra vires*; and in respect thereto the court said, in effect, that if such a purchase be *ultra vires*, it is not made penal or expressly prohibited: therefore the violation of law could be remedied only in proceedings against the bank, in the name of the state, to deprive it of its charter. In *Grant v. Henry Clay, etc., Co.*, 80 Pa. St. 208, where the question was whether the corporation could purchase or hold leases of mining lands, the court, in deciding such question, said, in effect, that if the commonwealth is interested in such an inquiry, it must be made by the proper officer; that the question was of a public nature, concerning solely the sovereignty of the state, and not one that in any way concerned private parties. In *Martindale v. Kansas City, etc., R. R. Co.*, 60 Mo. 508, the question was whether the defendant had violated statutory requirements, and the court laid down the broad doctrine that collateral inquiry by a private citizen into the supposed illegal acts of a corporation is not permitted in any case, unless expressly so provided by statute. To the same effect are *Kinealy v. St. Louis, etc., R. R. Co.*, 69 Mo. 658, and *Hovelman v. Kansas City, etc., Co.*, 79 Mo. 632. In *Baker v. North Western, etc., Loan Co.*, 36 Minn. 185, the question was, whether the purchase and enforcement of certain mortgage liens was in excess of the corporate authority. Held, that none but the state or a stockholder could raise the question.

If the position that the principle under discussion is now, in most jurisdictions, recognized as one of general application, except in respect to contracts wholly executory, required further support, resort might be had to many other adjudications of the highest respectability, though authorities there are which still adhere to the old rule that a corporate act in excess of its power, either because outside of the purposes of the corporation or because prohibited by statute, is *ultra vires*, and can not be enforced in any action in any court of justice, without regard to whether such act be challenged by the public or by a private person. Such authorities are exceptional. Judge Thompson, in his valuable treatise on the Law of Corporations, volume 5, sections 6033-6038, commenting on the subject, appears to deprecate the prevalence of the "new doctrine," and to argue against its further extension, upon the ground that it practically destroys the effect of the doctrine of *ultra vires*, as applied to the unauthorized exercise of corporate power; but the learned author is manifestly in error in that respect. Such doctrine, notwithstanding the limitation which modern development has placed on the means by which it may be called into use, still exists, and may and will continue to exist, adapted as fully as ever to restrain the abuse of corporate franchises and au-

thority, and to punish such abuse whenever the state, in its sovereign capacity, sees fit to exercise it. That such doctrine can not be resorted to as a weapon for attack and defense in the hands of mere private persons, and used as a ready means of embarrassing business operations by and with corporate bodies, which directly or indirectly touch and administer to human desires at every turn of the individual in modern life, while its effectiveness for all essential purposes of restraint and punishment is fully preserved, furnishes no cause for regret, but rather cause for gratification at the evidence of how certainly principles, by natural growth and development, adapt the law and its administration to the ever-changing needs of advancing civilization so as best to promote justice and the common welfare. When a corporation offends against the law of its creation, such offense is against the sovereignty of the state; hence it is most proper that the state should apply the remedy and be charged with the sole responsibility in that regard, and such is the law by the trend of modern authorities, which we approve. This does not hold but that a person directly interested as a stockholder may, in a proper case, interfere, or but that the court may refuse, on its own motion or the objection of a private person, to aid a corporation to enforce, or protect it from the effect of, a contract wholly executory, when outside the purposes of the corporate organization.

In accordance with the foregoing, we hold that if a corporation purchases, pays for and takes an assignment of a cause of action respecting matters outside the purposes of its creation and not authorized by its charter, in any action to enforce such cause of action, want of corporate power to engage in such business can not be interposed as a defense.

(After holding the claims were not assignable, the decision was reversed on this ground.)

*Note. See, Accord:* 1848, *Barrow v. Turnp. Co.*, 9 *Humph. (Tenn.)* 304; 1853, *South Ins. Co. v. Lahier*, 5 *Fla.* 110, 58 *Am. Dec.* 448; 1870, *Pacific R. Co. v. Seeley*, 45 *Mo.* 212, 100 *Am. Dec.* 369; 1878, *National Bank v. Matthews*, 98 *U. S.* 621; 1882, *Wright v. Pipe Line Co.*, 101 *Pa. St.* 204, 47 *Am. Rep.* 701; 1883, *St. Louis Drug Co. v. Robinson*, 81 *Mo.* 18; 1889, *State v. Thresher Co.*, 40 *Minn.* 213; 1890, *Commonwealth v. N. Y., etc., R. Co.*, 132 *Pa. St.* 591, *supra*, p. 1014; 1895, *Nashua, etc., Corp. v. Boston, etc., R. Corp.*, 164 *Mass.* 222, 49 *Am. St. Rep.* 454; 1897, *Farrington v. Putnam*, 90 *Maine* 405, *supra*, p. 1029. Compare 1901, *City of Pueblo v. Shutt Invest. Co.*, 28 *Colo.* 524, 89 *Am. St. R.* 221.

### ARTICLE III. VARIOUS INTERESTS AFFECTED.

**Sec. 364.** The state, the parties, the shareholders, the creditors.

SAWYER, C. J., IN MINERS' DITCH CO. v. ZELLERBACH.

1869. IN THE SUPREME COURT OF CALIFORNIA. 37 *Cal. Rep.* 543, on 577-8, 586-8; 99 *Am. Dec.* 300, on 306-7, 314-16.

In considering the cases in which the law applicable to corporations is discussed, it must, also, always be borne in mind that there are sev-



eral classes of rights to which they apply, and that upon the same general state of facts, the legal consequences might be different with reference to the different classes of rights. Thus there are corporate rights—that is to say, rights which pertain to the corporation *as such*—the artificial legal entity created by the act of incorporation, considered as a single, distinct person; individual rights of the stockholders *as such*, and rights of the creditors of the corporation. The rights of strangers dealing with the corporation may vary according as they are considered with reference to the corporation itself, the stockholders, or the creditors of the corporation. So, also, there are several classes of corporations, such as public municipal corporations, the leading object of which is to promote the public interest; corporations technically private, but yet of a *quasi*-public character, having in view some great public enterprise, in which the public interests are directly involved to such an extent as to justify conferring upon them important governmental powers, such as an exercise of the right of eminent domain. Of this class are railroad, turnpike and canal companies, and corporations strictly private, the direct object of which is to promote private interests, and in which the public has no concern, except the indirect benefits resulting from the promotion of trade, and the development of the general resources of the country. They derive nothing from the government, except the right to be a corporation and to exercise the powers granted. In all other respects, to the extent of their powers, they stand upon the footing of natural persons, having such property as they may legally acquire, and holding and using it ultimately for the exclusive benefit of the stockholders. In this last class, the stockholders and those dealing with the corporation are the only parties directly and immediately interested in their acts, so long as the corporation confines itself within the general scope of its powers. The rights of the corporation, the corporators and of strangers dealing with the corporation, may, in some respects, vary according to the circumstances surrounding a given transaction.

The term *ultra vires*, whether with strict propriety or not, is also used in different senses. An act is said to be *ultra vires* when it is not within the scope of the powers of the corporation to perform it under any circumstances or for any purpose. An act is also sometimes said to be *ultra vires* with reference to the rights of certain parties, when the corporation is not authorized to perform it without their consent, or with reference to some specific purpose, when it is not authorized to perform it for that purpose, although fully within the scope of the general powers of the corporation, with the consent of the parties interested, or for some other purpose. And the rights of strangers dealing with corporations may vary, according as the act is *ultra vires* in one or the other of these senses. All these distinctions must be constantly borne in mind in considering a question arising out of dealings with a corporation. When an act is *ultra vires* in the first sense mentioned, it is generally if not always void *in toto*, and the corporation may avail itself of the plea. But when it is *ultra vires*

in the second sense, the right of the corporation to avail itself of the plea will depend upon the circumstances of the case. \* \* \*

The question, as between stockholders and the corporation, is a very different one from that which arises between the corporation itself and strangers dealing with it; and the principle established, where the contest arises between strangers and the corporation, is, whether the act in question is one which the corporation is not authorized to perform under any circumstances, or one that may be performed by the corporation for some purposes, but may not for others. In the former case the defense of *ultra vires* is available to the corporation as against all persons, because they are bound to know, from the law of its existence, that it has no power to perform the act. But in the latter case the defense may or may not be available, depending upon the question whether the party dealing with the corporation is aware of the intention to perform the act for an unauthorized purpose, or under circumstances not justifying its performance. And the test, as between strangers having no knowledge of an unlawful purpose and the corporation, is to compare the terms of the contract with the provisions of the law from which the corporation derives its powers; and if the court can see that the act to be performed is necessarily beyond the powers of the corporation for any purpose, the contract can not be enforced; otherwise it can. Or, in the language of Mr. Justice Selden, in the case before cited: "Where the want of power is apparent, upon comparing the act done with the terms of the charter, the party dealing with the corporation is presumed to have knowledge of the defect, and the defense of *ultra vires* is available against him. But such a defense would not be permitted to prevail against a party who can not be presumed to have had any knowledge of the want of authority to make the contract. Hence, if the question of power depends not merely upon the law under which the corporation acts, but upon the existence of certain extrinsic facts resting peculiarly within the knowledge of the corporate officers, then the corporation would, I apprehend, be estopped from denying that which, by assuming to make the contract, it had virtually affirmed." (22 N. Y. 290.) Strangers are presumed to know the law of the land, and they are bound, when dealing with the corporations, to know the powers conferred by their charter. These are open to their inspection, and it is easy to determine whether the act is within the scope of the general powers conferred for that purpose. But they have no access to the private papers of the corporation, or to the motives which govern directors and stockholders, and no means of knowing the purposes for which an act, that may be lawful for some purposes, is done. The very fact that the appointed officers of the corporation assume to do an act in the apparent performance of their duties which they are authorized to perform for the lawful purposes of the corporation, is a representation to those dealing with them that the act performed is for a proper purpose. And such is the presumption of the law, and upon this presumption, strangers having no notice in fact of the unlawful purpose, are entitled to rely. To this effect is

the principle of the following, among other cases, as well as those already cited: *Commissioners of Knox County v. Aspinwall*, 21 How. (U. S.) 545, is a strong case applying this doctrine to public corporations. *Gelpecke v. City of Dubuque*, 1 Wallace (U. S.) 203, and cases cited; *Bank of United States v. Dandridge*, 12 Wheat. 64.

Upon any other principle there would be no safety in dealing with corporations, and the business operations of these institutions would be greatly crippled, while the interests of the stockholders and the public, and their general usefulness, would be seriously impaired. The officers are appointed by the corporation, and if any loss results to strangers dealing with the corporation from their misrepresentation in matters within the general scope of their duties, it should fall upon the corporation, which is responsible for their appointment, rather than upon parties who have no other means of ascertaining the facts, and must rely upon their assurances or not deal with the corporation at all.

See cases below under Art. V, p. 1233.

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#### ARTICLE IV. APPLICATIONS OF THE DOCTRINE.

##### Sec. 365. 1. Contracts

###### (a) Wholly executed by both parties.

See *Leazure v. Hillegas*, 7 Serg. & R. 313, *supra*, p. 1008.

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##### Sec. 366. Same.

###### LONG v. GEORGIA PACIFIC RAILWAY COMPANY.<sup>1</sup>

1891. IN THE SUPREME COURT OF ALABAMA. 91 Ala. Rep. 519-523, 24 Am. St. Rep. 931.

MCCLELLAN, J. The case made by the amended bill is this: On April 23, 1883, the complainant, B. M. Long, and his wife, Amanda C. Long, executed to the Georgia Pacific Railway Co. a deed, upon valuable consideration presently paid, to and of the iron, coal and oil interests and properties in and pertaining to certain tracts of land, aggregating about four thousand acres; the said Long retaining the fee to said lands, except in respect to said mineral interests, and continuing in possession thereof. The grantee is a corporation, and was and is without power to purchase and hold said land, or the mineral interests in the same. The bill seeks to have the deed declared void,

<sup>1</sup> Arguments and part of opinion omitted.



because of this incapacity of the corporation, and to have the same canceled as a cloud upon complainant's title. The bill was demurred to on several grounds, and the demurrer was sustained generally, the decree to that end being now assigned as error.

Only those grounds of error which present the question, whether a vendor who has sold, received payment for, and conveyed land to a corporation which had no power to hold the same, can have any relief in respect to the transaction, are discussed in argument, and to these our consideration will be confined, since it is manifest that the determination of this question, in line with the decree below, as we think it must be determined, will be fatal, not only to the present appeal, but to complainant's cause of action.

It is thoroughly well-settled law that a party to an *ultra vires executory* contract made with a corporation is not estopped to set up the want of corporate capacity in the premises, either by the fact of contracting, whereby the power to contract is, in a sense, admitted or recognized, or by the fact that the fruits or issues of the contract have been received and enjoyed, and this, though the assault upon the transaction comes from the corporation itself. *Marion Savings Bank v. Dunkin*, 54 Ala. 471; *Chambers v. Falkner*, 65 Ala. 448; *Sherwood v. Alvis*, 83 Ala. 115; *Chewacla Lime Works v. Dismukes*, 87 Ala. 344. But where the contract is fully executed—where whatever was contracted to be done on either hand has been done—a different rule prevails. In such case the law will not interfere, at the instance of either party, to undo that which it was originally unlawful to do, and to the doing of which, so long as the contract to that end remained executory, neither party could have coerced the other. As declared by Mr. Bishop, "the parties voluntarily doing of what they have unlawfully agreed, places them, in effect, in the same position as if the contract had been originally good; neither can recover of the other what was parted with. The reason for which is, that, since they are equally in fault, the law will help neither." *Bishop on Contracts*, § 627.

The former decisions of this court are in line with this doctrine, and fully recognize the distinction between executory and executed void contracts, to the effect that, while suits to enforce the former may always be defended on the ground of their invalidity, no relief prayed upon such ground can be granted with respect to the latter. *Morris v. Hall*, 41 Ala. 510; *Ingersoll v. Campbell*, 46 Ala. 282; *Sherwood v. Alvis*, 83 Ala. 115; *Dudley v. Collier*, 87 Ala. 431; *Craddock v. Mortgage Co.*, 88 Ala. 281. And this is the doctrine generally declared by other courts. *Thomas v. Railroad Co.*, 101 U. S. 71; *Day v. S. S. B. Co.*, 57 Mich. 146, 58 Amer. Rep. 352; *Parish v. Wheeler*, 22 N. Y. 494; *Miners' Ditch Co. v. Zellerbach*, 37 Cal. 543, 606; *Terry v. Eagle Lock Co.*, 47 Conn. 141.

There is no question but that the case presented by the bill involved a contract on the part of the railway company to buy, and on the part of the complainant to sell, certain interests in the land described. It is equally clear that the payment of the agreed price on the one hand,

and the execution of the conveyance on the other, fully executed this contract on both sides, left nothing to be done by either party in the premises, and bring the transaction within the principle we have been considering, which denies to the complainant any relief in respect to it.

The same conclusion is reached by another well-established principle. It is, that when a party sells and conveys property to a corporation, which is without power to purchase and hold the same, and receives compensation therefor, there being no fraud in the transaction, he is in no sense injured or prejudiced by the incapacity of the corporation, nor can he be heard to complain of it; but the question becomes one between the corporation and the state, the sovereign alone having the right to impeach the transaction; and until it supervenes for this purpose, the corporation is vested with perfect title against all the world, defeasible only on office found. *R. & B. Railroad Co. v. Proctor*, 29 Vt. 93; *Leazure v. Hillegas*, 7 Serg. & Rawle 313; *Goundie v. Northampton Water Co.*, 7 Pa. St. 233; *Baird v. Bank of Washington*, 11 Serg. & Rawle 411; *Lathrop v. Bank*, 8 Dana 114, 129; *Hough v. Cook County Land Co.*, 73 Ill. 23, 24 Amer. Rep. 230; *Cowell v. Springs Co.*, 100 U. S. 55; *Reynolds v. Crawfordsville Bank*, 112 U. S. 405, 413; 2 Mor. Corp., § 710.

*Affirmed.*

*Note.* See *Am. Un. Tel. Co. v. U. P. R. Co.*, 1 McCrary 188, *infra*, p. 1225; *St. Louis, V. & T. H. R. Co. v. T. H. & I. R. Co.*, 145 U. S. 393, *infra*, p. 1228. Also, note 70 Am. St. Rep. 156, *et seq.*; 1897, *Horne v. Pollak*, 118 Ala. 617, 72 Am. St. Rep. 189, note 194.

## Sec. 367. (b) Wholly executory.

### (1) Corporation complainant.

#### THE NASSAU BANK v. JONES.<sup>1</sup>

1884. IN THE COURT OF APPEALS OF NEW YORK. 95 N. Y. Rep. 115-124.

RUGER, C. J. The question involved in this case, as we regard it, is the right of a banking corporation chartered under the laws of this state to subscribe for the stock of a railroad corporation.

In the spring of 1879, the Denver and Rio Grande Railroad Company, being a corporation organized to construct railroads in Colorado and adjoining territories, with the view of raising money to extend its lines, published a circular, whereby it proposed, in substance, to issue \$5,000,000 of its bonds, in sums of \$1,000 each, payable thirty years after date, with annual interest at 7 per cent. in gold, secured by mortgage upon its property; and to deliver one of such bonds, together with five shares of its capital stock, of the par value of \$100 per

<sup>1</sup> Arguments and part of opinion omitted.

share, to each and every person who should advance thereon the sum of \$900, reserving, however, the privilege to the railroad company of withdrawing the proposition when it should have received subscriptions to said loan to the amount of \$3,000,000. This proposal was favorably received, and the loan was subscribed for by citizens and corporations in various states of the union, to an amount greatly exceeding the sum required by the railroad company. Among others the defendants' testator, one David Jones, subscribed for, and was awarded \$90,000 of such contemplated loan. It is claimed by the appellant, and was found as a fact by the trial court, that Jones undertook, by the authority and for the benefit of the plaintiff, to contract with this railroad company for a loan, under its proposal, in the name of the plaintiff, to the extent of one-half of the amount which should be allotted to him; and by this action the appellant seeks to recover from Jones' executors, among other things, the profits claimed to have been made by him upon its share of the transaction. The right to maintain the action seems to depend upon the power of the bank to enter into the proposed contract, for if it had no lawful authority to make such a contract it could not become liable to Jones upon its obligation to take and pay for the property contracted for; and consequently there would be no consideration for Jones' undertaking to subscribe for the benefit of the bank. Not only this, but the bank could not, by suit, enforce against any one an executory contract which it was unauthorized by its charter to make.

(After holding that the bank was not authorized to purchase the stock.)

The contract between the plaintiff and Jones was wholly executory, and nothing has occurred thereunder preventing the bank from setting up its own want of authority to make such a contract as a defense to any action brought thereon by Jones.

While executed contracts, made by corporations in excess of their legal powers, have, in some cases, been upheld by the courts, and parties have been precluded from setting up, as a defense to actions brought by corporations, their want of power to enter into such contracts (*Bissell v. M. S. & N. I. R. R. Co.*, 22 N. Y. 258; *Whitney Arms Co. v. Barlow*, 63 N. Y. 62; *Woodruff v. E. R. Co.*, 93 N. Y. 618), this doctrine has never been applied to a mere executory contract which is sought to be made the foundation of an action, either by or against such corporations. It was said by Judge Selden, in *Tracy v. Talmage* (14 N. Y. 179), "That a contract by a corporation, which it has no legal capacity to make, is void and can not be enforced, it would seem difficult to deny." In *White v. Buss* (3 Cushing 448), Chief Justice Shaw lays down the rule as follows: "It is well settled by the authorities that any promise, contract or undertaking, the performance of which would tend to promote, advance or carry into effect an object or purpose which is unlawful, is in itself void and will not maintain an action."

Lord Mansfield, in *Smith v. Bromley* (2 Douglas, 696), says: "If the act is in itself immoral, or a violation of the general laws of pub-

lic policy, then the party paying shall not have this action." In *Tracy v. Talmage* (*supra*, 217) Judge Comstock says: "It is admitted that the contract of a corporation, which it has no legal capacity to make, can not in its terms be enforced."

There is nothing in this case to exempt the plaintiff from the operation of the general principle determined in the cases referred to.

Jones owed no duty to the plaintiff, except that which sprang out of his engagement to purchase the stock and bonds in question; and that having failed on account of its illegality, left no enforceable obligation resting upon him. (*Levy v. Brush*, 45 N. Y. 589.) There is no pretext for the claim that the contract was in any respect an executed one, for Jones never even entered upon its performance. His subscription for the loan in his own name was in direct violation of the obligation which it is claimed that he had assumed; and it is that obligation alone which is sought to be enforced in this action. The bank, by the transaction in question, secured Jones' promise to do certain things, and has relied solely upon that promise. It has done nothing in performance of the contract, and, so far as it is concerned, the contract remains wholly executory.

Neither can Jones be treated as a trustee for the benefit of the plaintiff; a trust whereby it is attempted to accomplish an illegal purpose is quite as objectionable as a direct contract to effect the same object.

The law does not raise an implied obligation to effectuate a purpose which is forbidden, and which can not be effected by the parties through the agency of an express contract. (*Perry on Trusts*, § 214.)

The claim here is that a trust should be implied to enable the plaintiff to reap the profits from a transaction in which it was not authorized by law to engage. We have found no authority which supports such a claim and are unable to discover any ground upon which this action can be maintained.

It follows that the judgment should be affirmed.

All concur except Rapallo and Earl, JJ., dissenting.

Judgment affirmed.

*Note.* To same effect, see *N. W. U. Packet Co. v. Shaw*, 37 Wis. 655, *supra*, p. 1040.

See, also, note, 70 Am. St. Rep. 156, *et seq.*

## Sec. 368. (2) Other party complainant.

### LUCAS v. WHITE LINE TRANSFER COMPANY.<sup>1</sup>

1886. IN THE SUPREME COURT OF IOWA. 70 Iowa Rep. 541, 59 Am. Rep. 449-456.

[Action by co-surety for contribution. The Valley National Bank (by Lucas, its cashier) and the White Line Transfer Company be-

<sup>1</sup> Statement abridged, part of opinion omitted.

came sureties for L. & M., beer merchants, to the Best Brewing Company. Upon L. & M. failing in business they executed their note to the bank and transfer company, payable on demand, in consideration of the payees assuming to pay the debt to the brewing company. When the brewing company demanded payment, the bank asked the transfer company to pay its share, and it refused; whereupon the bank paid the sum due, and then brought an attachment suit in its name and that of the defendant, against L. & M., obtained judgment, and realized thereon a small sum, leaving over \$1,300 yet unpaid; the bank sues for half of this. The transfer company filed an answer setting up that it had no power, nor were its officers authorized to make such a contract. The bank demurred to this answer; the court below sustained the demurrer, and gave judgment for plaintiff. Defendant appealed.]

ROTHRICK, J. The principal question involved in the appeal is the ruling on the demurrer interposed by plaintiff against defendant's answer. It is true, the demurrer seems to be based on the idea solely that by the conduct of the defendant subsequent to signing the original bond it has estopped itself from setting up the plea of want of power or authority to sign the bond. The two following propositions are proper to be considered: 1. Had the officers of the defendant power to bind the corporation by placing its name on the bond in question? 2. If they had no such power, has the corporation, or its officers, so acted in relation thereto subsequently as to prevent or estop the corporation from now setting up the plea of want of power?

The corporation defendant is acting under the general incorporation laws of the state, and from the provisions of its articles and the statute it derives its power. A corporation exists and exercises its franchise only by virtue of a grant from the legislative power. The granting and acceptance of a charter in the case of private corporations for pecuniary profit are based on the theory that the prosecution of the business proposed will be a benefit to the public, and that the investment of capital therein will result in pecuniary profit to the stockholders, and that it is an undertaking, on the part of the corporation and all of its stockholders, that in consideration of the grant of power the capital shall be used for the prosecution of the purpose named in the charter, and no other. There is also an undertaking on the part of the corporation with each stockholder that the capital he invests shall be put to no other use and subject to no other hazard than that contemplated by the powers expressed in the charter, and that those things which are within the scope or object of the corporation shall be done in the manner pointed out in the charter and the laws governing its action. But corporations and their officers do not always keep within their powers, and the application of the doctrine of *ultra vires* is often attended with very perplexing questions. By the application of a few plain rules, however, we may readily reach the proper answer to the question involved in the case.

1. Every person dealing with a corporation is charged with

knowledge of its powers as set out in its recorded articles of incorporation.

2. Where a corporation exercises powers not given by its charter, it violates the law of its organization, and may be proceeded against by the state, through its attorney-general, as provided by the statute, and the unanimous consent of all the stockholders can not make illegal acts valid. The state has the right to interfere in such case.

3. Where a third party makes with the officers of a corporation an illegal contract beyond the powers of the corporation, as shown by its charter, such third party can not recover, because he acts with knowledge that the officers have exceeded their power, and between him and the corporation or its stockholders no amount of ratification by those authorized to make the contract will make it valid.

4. Where the officers of a corporation make a contract with third parties in regard to matters apparently within their corporate powers, but which upon the proof of extrinsic facts (of which such parties had no notice) lie beyond their powers, the corporation must be held, unless it may avoid liability by taking timely steps to prevent loss or damage to such third parties; for in such cases the third party is innocent, and the corporation or stockholders less innocent for having selected officers not worthy of the trust reposed in them.

5. This class of cases may be illustrated by that where the officer of a corporation, empowered to build and operate a certain line of railroad, purchase iron to be used for another line, without the knowledge of the vendee. So in case of *Humphrey v. Patrons' Mercantile Association*, 50 Iowa 607, the debts of the corporation were, by its articles, limited to a certain amount, but the officers of the association, in dealing with Humphreys, exceeded that amount without his knowledge, or means of knowledge, and the corporation was held. *Thompson v. Lambert*, 44 Iowa 239, belongs to the same class of cases, with the addition that in the last case the stockholders, who objected to what they termed an *ultra vires* contract, were charged with knowledge of and participation in the act they claimed to be illegal, and were in no situation to complain. A corporation can not retain benefits derived from an *ultra vires* contract, and at the same time treat the contract as entirely void, unless perhaps in cases where the other party has assisted willfully in putting it beyond the power of the corporation to return what is received on such contract.

6. Where the corporation has permitted its officers to engage in *ultra vires* transactions, and in the prosecution of such transactions the officers commit a wrong or tortious act without the fault of the injured party, the corporation is estopped from taking advantage of the *ultra vires* character of the original undertaking.

These rules do not cover all cases, but are sufficient to guide us in the determination of the question of this case.

(After considering the power of defendant to make the contract, proceeds:)

It seems to us clear that the corporation defendant had no power to make the contract of suretyship in question, and for the same reasons,



it is just as clear that the officers of the corporation had no power to sign the letter of May 27, purporting to assume the payment of the amount stipulated in the bond. Both instruments, so far as the defendant was concerned, were illegal and void, and no attempted ratification by parties having no power to make the original contract could make it valid, no matter how often such attempts were made. It is questionable on the authorities whether even the consent of all the stockholders could make the contract valid, when it was so plainly beyond the powers granted by their corporation, which was in duty to the legislative authority held to apply its capital to the prosecution of the business for which it was organized, and for which it received the grant of power. But this we need not determine. It is very clear, however, on authority and on principle, that there could not be a ratification without the consent of all the stockholders.

It appears from the record that the note sued on in attachment proceedings, and the proceedings themselves, were taken and carried through without the knowledge or assent of the stockholders or directors, and that the corporation defendant received no benefit therefrom, for whatever was realized therein was applied on the contract of suretyship, which was void as against the defendant, and was so applied by plaintiff or other unauthorized parties. *Tracy v. Guthrie Co. Agr'l Soc.*, 47 Iowa 27.

It is further claimed that the corporation defendant, by its signature to the bond and letter, induced the plaintiff to become liable on the bond and letter also, and induced plaintiff also to pay the amount of the bond. It is stated, however, in the petition, that the defendant refused to pay its half, and it must be borne in mind, in view of what has preceded, that the brewing company and plaintiff were all the while, at and after the time of signing the bond, charged with notice that the officers of the defendant were not authorized to bind the defendant, and that attempts to do so on their part were illegal and void; and in this respect defendant's stockholders are innocent parties, while the plaintiff is not.

We are therefore of the opinion that the circuit court erred in sustaining the demurrer to the answer of the transfer company, and its ruling thereon is reversed and the cause remanded.

*Judgment reversed.*

*Note.* To same effect, see *Coppin v. Greenlees Co.*, 38 Ohio St. 275, *supra*, p. 1048.

**Sec. 369.** (c) Partly executed.

(1) Fully performed by the corporation, enforceable by it.

**BOND v. THE TERRELL COTTON AND WOOLEN MANUFACTURING CO.<sup>1</sup>**

1891. IN THE SUPREME COURT OF TEXAS. 82 Texas Rep. 309-314.

TARLTON, J. This suit was brought November 9, 1889, by appellee against J. R. Bond and others, in the district court of Kaufman county, to recover a balance due of \$875 on a promissory note executed January 23, 1888, by appellants (J. R. Bond as principal and the others as sureties) in favor of appellee, and due twelve months from date.

Defendants answered that the note was executed in consideration of money loaned by plaintiff to the principal, Bond; that plaintiff at the time it made the loan was a private corporation under the laws of Texas, and was by its charter authorized and empowered to manufacture and vend cotton and woolen goods, and do other acts incident and necessary thereto; that under its charter plaintiff had no authority to loan money; that for more than seven years before the institution of the suit plaintiff had not engaged in the manufacture and sale of cotton and woolen goods, but had confined its operations to loaning money; that the note was void.

(Plaintiff put in a reply, and trial was had, resulting in judgment for plaintiff, the court finding the law to be as follows:) \* \* \*

1. The plaintiff, under its charter, had no power or right to loan defendants its funds or capital.

2. Defendants, having received the money for which the note was executed by them, are estopped from denying the power of plaintiff to loan the money.

The last finding of the court is assigned as error, and presents the only question to be considered by us, viz.: Are the appellants, who have received the money in consideration of which they executed the note sued on, in a position to question the appellee's right of recovery?

In considering the question, it will be conceded that the court was correct in finding that the act of the plaintiff corporation in loaning the money was *ultra vires*.

It seems now to be settled by the great weight of authority, that where there is a question of a contract between a corporation and another party, and the contract has been performed by the other party, and the corporation has received the benefit of the contract, it will not be permitted to plead that on entering into the contract it exceeded its chartered powers. *Railway v. Gentry*, 69 Texas 632, and the numerous authorities there cited. This rule operates conversely. If

<sup>1</sup> Statement abridged; arguments and part of the opinion omitted.



the other party has received from a corporation the benefit of a contract fully performed in good faith by it, he will not be heard to resist enforcement of the contract as to him by pleading the mere want of power in the corporation to enter into the contract. *Arms Co. v. Barlow*, 63 N. Y. 70; *Darst v. Gale*, 83 Ill. 136; *Bradley v. Ballard*, 55 Ill. 417; *Cozart v. Railway*, 54 Ga. 379; *Tel. Co. v. Railway*, 1 Fed. Rep. 745; *Dimpfel v. Ohio, etc., Co.*, 110 U. S. 209; *Hitchcock v. Galveston*, 96 U. S. 341; *Natchez v. Mallory*, 54 Miss. 497; *Thompson v. Lambert*, 44 Iowa 239; *Railway v. Alleghany Co.*, 79 Pa. St. 210, 215; *Watts' Appeal*, 78 Pa. St. 370, 392; *De Groff v. Am., etc., Co.*, 21 N. Y. 124; *Gallion v. Hays*, 29 Ohio St. 330, 340; *Railway v. McCarthy*, 96 U. S. 258, 267; *Bliss v. Loan Co.*, 30 N. W. Rep. 465. This rule is supported by the more modern decisions, and seems to us to be founded in the suggestions of fair dealing and honesty. It does not appear, though the loaning of the money by the corporation to the appellant Bond was *ultra vires*, that his rights were in any way infringed by the transaction. Why, then, should he be heard to complain? If he should return the money which he received, he would be doing but an act of justice in restoring it to the stockholders of the corporation to whom it legitimately belongs. Meanwhile, if on account of the public welfare he feel solicitous that the corporation should be prevented from engaging in future loaning operations in excess of the power conferred by the statute under which it is organized, the remedy against such a usurpation can at any time be invoked by him. He could easily become the relator in a *quo warranto* proceeding to be instituted under article 4089i of the Revised Statutes. \* \* \*

*Affirmed.*

See note, 70 Am. St. Rep. 156, *et seq.*, and cases cited in note to § 361, *supra*.

## Sec. 370. Same. Contra.

### GRAND LODGE OF ALABAMA v. WADDILL.<sup>1</sup>

1860. IN THE SUPREME COURT OF ALABAMA. 36 Ala. Rep. 313-319.

[Action by the Grand Lodge of Freemasons of Alabama to recover \$2,753.75, loaned by it to the defendants, evidenced by a note signed by them and made payable to the plaintiff one year after date. The complaint contained a count on the note, and the common count for money loaned.]

A. J. WALKER, C. J. The defendants and George P. Blevins, as to whom the suit abated in consequence of his death, executed their promissory note for the consideration of money loaned by the plaintiff.

<sup>1</sup> Statement abridged, arguments and part of opinion omitted.

The recovery of the money was resisted, upon the ground that the plaintiff had no authority to make a loan of money; and the court below, by its charge, sustained the defense. We are constrained by our convictions of the law to approve the charge.

The authority of corporations is limited by their chartered powers, and the necessary and proper means of executing those powers. *City Council of Montgomery v. M. & W. P. R. Co.*, 31 Ala. 76; *Ex parte Burnett*, 30 Ala. 461; *M. & A. v. Allaire*, 14 Ala. 400; *Smith v. Ala. L. I. & T. Co.*, 4 Ala. 558; *State v. M. & A. of Mobile*, 5 P. 279, 309; *State v. Stebbins*, 1 St 299; *Straus v. E. Ins. Co.*, 5 Ohio St. 59; *A. & A. on Cor.* 270, § 256.

(After considering the provisions of the charter, proceeds:)

There is no specified power granted to this corporation, in the exercise of which the loaning of money becomes an appropriate or necessary means. Nor is there any purpose to be accomplished by the corporation, as indicated in the charter, which requires a resort to the loaning of money. There is some evidence afforded by the third section that the purpose of the society is charity; but the loaning of money is by no means a necessary means of accomplishing charitable purposes.

Contracts of corporations, which they have no power to make, are void, and courts of justice will not enforce them. So, also, promissory notes and other instruments, given to secure the performance of the contract, are void. No action to enforce the contract, whatever form the pleader's skill may give it, can be maintained. 3 Wend. 582; 7 Wend. 34; 25 Wend. 648; 5 Barb. 20. It is true that money loaned may be recovered under a common money count. But then a recovery under a common count in this case would be an enforcement of a void contract, as effectually as if it had been under a special count, setting forth the contract.

The decision in *Waddill v. Ala. & Tenn. Rivers R. Co.* (35 Ala. 323) has no pertinency to this case. In that case the money was loaned without the authority of the corporation. Here such is not shown to have been the case. The corporation, transcending its powers, made the loan.

Judgment affirmed.

*Note.* See, to same effect, 1880, *Chambers v. Falkner*, 65 Ala. 448; 1893, *Marble Co. v. Harvey*, 92 Tenn. 115, 36 Am. St. Rep. 71, and, generally, note to § 360, *supra*.

Sec. 371. (2) Fully performed by other party, not enforceable by him.

MILLER v. INSURANCE COMPANY.<sup>1</sup>

1893. IN THE SUPREME COURT OF TENNESSEE. 92 Tenn. Rep. 167-187, 20 L. R. A. 765, 21 S. W. Rep. 39.

[Appeal from judgment of the circuit court in favor of the defendant. The action was to recover upon an accident policy issued by the company, for loss of arm due to the accidental discharge of a gun which the plaintiff undertook to clean. The insurance company was organized in 1887, under the law of 1875, and authorized to insure against accidents in traveling. The law of 1875 reserved to the state the right to repeal, alter or amend the same, and in case of any material amendment made, the same was to be submitted to the shareholders, and if a majority of these accepted it, it should become binding upon the company, and the stock of dissenting members should be paid for by the company. If the amendment was rejected, then the company was to wind up its affairs and go out of business. In 1889 an amendment was offered by the state, authorizing all companies organized under the law of 1875 to insure against "disabilities by sickness, or disease, or other bodily infirmities." This amendment was neither accepted nor rejected by any regular corporate action. The company, however, continued to do business, and in 1890 insured the plaintiff "against external bodily injury effected through external violent and accidental means." It was admitted that plaintiff had no actual knowledge of a want of power of the company under the act of 1875 to issue such a policy, or that the company had not accepted the amendment of 1889. The company claimed the policy was void for want of authority to issue it under the law of 1875, and that it had not accepted the amendment of 1889, and the court below so held. The plaintiff claimed: 1. That since the contract was fully executed upon his part, the company could not rely upon the doctrine of *ultra vires*; and, 2. That because it insured him against a loss not sustained in traveling, it assumed to exercise power under the amendment, and thereby so represented to him its acceptance, and was thereby estopped to show it had not in fact accepted the amendment.]

LURTON, C. J. \* \* \* We recognize a diversity of opinion in the courts of America as to the right of either party to rely upon the defense of *ultra vires*, when the contract is not expressly prohibited, and is not immoral, and has been fully executed upon one side. The theory upon which the cases rest, which hold that the defense is not to be entertained when the act is one merely in excess of express authority, seems to be that such a contract should be regarded as a mere breach of duty by the agents of the corporation, and that the state has ample remedy for such abuse, or for a usurpation of power, in a proceeding to annul the charter; that to permit such a defense is

<sup>1</sup> Statement abridged, and part of opinion omitted.

of no service to the state in preventing corporate usurpation, or in promoting the public interest, and only operates to encourage dishonesty and promote injustice. Resting upon one or more of these arguments, many cases might be cited. There are, then, a class of cases which take a distinction between acts merely in excess of authority and those which, in addition, are affirmatively forbidden or immoral, or in contravention of some principle of public policy.

It seems to us that the true foundation of the doctrine of *ultra vires* lies in the proposition that every act of a corporation in excess of its power is an act in contravention of public policy, and for that reason to be held null and void. The ground upon which corporate privileges are conferred is, that the public interests may be thereby subserved. If this is not so, then all such concessions are mere acts of legislative favoritism, and contravene the foundation upon which free government is supposed to rest—that all are to be protected in the enjoyment of equal rights and privileges. Charters must be supposed, therefore, to be granted upon the supposition that some public interest is thereby advanced. “The legislature is, therefore, presumed,” says Judge Selden, in *Bissell v. R. R.*, 22 N. Y. 285, “to have granted just so much power and so many peculiar privileges as these interests are supposed to require.”

It must be, therefore, that any act in excess of these granted powers is an act contrary to public policy, and, upon that ground, illegal and void. Any other view by which such acts are to be supported because executed would operate as an enormous practical extension of the power of corporations. The view this court has taken has, therefore, been that “all acts outside the object of its creation, as defined in the law of its organization, and, therefore, beyond the powers conferred upon it,” are acts not voidable only, but wholly void. *Buckeye Marble Co. v. Harvey*, 92 Tenn. 115; *Elevator Co. v. M. & C. R. R. Co.*, 85 Tenn. 705; *Mallory v. Oil Works*, 86 Tenn. 598.

The rule, and the foundation upon which it rests, as held by the English courts, is identical with our own. The English doctrine is summarized by Mr. Beach in these words: “Corporations are created for fixed purposes, with certain specified powers. It is deemed to be public policy to keep them strictly within the bounds so defined. There is an implied prohibition to go beyond such limits, and all persons dealing with a corporation are charged with notice of the limitations upon its authority. Therefore, every contract of a corporation or its agents which exceeds the powers of the corporation violates this implied prohibition, and contravenes such public policy, and is illegal and void. Consequently, as to such contracts, there can be no ratification or estoppel.” 2 Beach on Private Corporations, section 421. The Tennessee rule is in accord with the holding of many of the American courts. *Pittsburg Ry. Co. v. Keokuk Bridge Co.*, 131 U. S. 389; *Central Transportation Co. v. Pullman Co.*, 139 U. S. 60; *Davis v. Old Colony R. R. Co.*, 131 Mass. 258; *Chambers v. Falkner*, 65 Ala. 448; *Marion Savings Bank v. Dunkin*, 54 Ala. 471.

The remedy, in case one of the parties has received a benefit under

such a contract, which, *ex aequo et bono*, it ought not to retain, is a suit in disaffirmance and for an accounting. *Buckeye Marble Co. v. Harvey*, 92 Tenn. 115.

The plaintiff's suit is upon the contract, and in affirmance of it, and, if there be nothing else in the case, could not be maintained.

But is the defendant company, for any reason, estopped to show that this amendment had not been adopted?

(Quoting the provisions of the act of 1875 as to amendments.)  
\* \* \*

It is to be observed that the state does not by this act undertake to arbitrarily impose a fundamental alteration, and require the corporation to continue in business under the amendment. It does, however, demand that the corporation shall accept the amendment, however radical it may be, or continue its existence only for the purpose of winding up its business. In other words, the state says to every corporation to be organized under this law, "I reserve the right to repeal or amend this charter at any time. If the amendment I shall propose is vital and fundamental, it shall be submitted to the action of the stockholders. If a majority assent to it, and adopt it, then the corporation may continue in business. If there be any who are incapable of consenting, or any unwilling to accept, then all such shareholders shall cease to be shareholders, and the corporation shall be liable for the market value of all such shares. But if the amendment be unacceptable to a majority, then you shall exist only for the purpose of winding up your business, and shall have no power to enter upon any new contracts."

Under this act, if the alteration be fundamental, the corporation must do one of two things—accept the offered amendment or wind up.

The defendant says that it did neither. The law conclusively presumes that every officer, agent and stockholder of this company knows the general law of the state affecting its powers and its business. The corporation, regarded as an entity, must be taken to have known of the right reserved by the state to amend its charter. This right was written in its very face. It must be taken to have known that the state, by the act of 1889, had proposed an amendment. It must be taken to have known that it must accept this added power or it must cease to do business. It knew that every such corporation which should thereafter be found engaged in the doing of new business would be regarded by all who dealt with it as having all the powers conferred by the act of 1875, and the amendment of 1889. An act or contract within the scope of either of these general laws of the state was an act or contract within the apparent scope of the powers of any such company. All who deal with a corporation are bound to take notice of the limitations contained within the law of its creation. *Mor. on Corp.*, § 592; *Beach on Corp.*, § 383. But when an act or contract is within the apparent scope of its charter, and the defect in power depends upon some extrinsic fact peculiarly within the knowledge of the officers and agents of the corporation, and is

unknown to the person so dealing, then there is no presumption of a participation in doing the illegal act, and a different rule of responsibility applies from that enforced when the defect is apparent upon a comparison of the contract with the charter. \* \* \*

Let us apply this principle to the case in hand. One dealing with this corporation is bound to take notice of the statute and its amendments under which it was doing business. He was not bound to go any further. When he found this company engaging in new business after the amendment of its charter, under the act of 1889, he was bound to look to the limitations upon its powers contained in this amendment; for, finding it using the powers therein conferred, he had a right to presume that its stockholders had adopted this amendment. The question as to whether a stockholders' meeting had been held, and whether a majority of the stock had been voted for the amendment, were questions of internal management peculiarly within the knowledge of its officers and agents, and as to which it is conceded he had no knowledge. The making of the contract involved was a representation, as was the fact of its continuance in business by these officers and agents, that such a meeting had been held, and that a majority of the stock had accepted the offered power necessary to justify the making of the contract. \* \* \*

Certainly the contract in question was within the apparent scope of the power of this company, and a stranger in good faith dealing with it, had a right to assume that the necessary steps had been taken to accept the power its officers were assuming to have, and the company must be held estopped to show that a majority of its shareholders had not accepted it. \* \* \*

*Reversed.*

*Note. Accord: In re Assignment Mut. G. F. Ins. Co., 107 Iowa 143, 70 Am. St. Rep. 149 (forbidden contract), and note, p. 156.*

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**Sec. 372. Same. Contra.**

**DENVER FIRE INSURANCE COMPANY v. McCLELLAND.<sup>1</sup>**

1885. IN THE SUPREME COURT OF COLORADO. 9 Colo. Rep. 11-29, 59 Am. Rep. 134.

[Action by McClelland to recover for loss of property insured against damage by hail, under policy issued by the insurance company. The declaration stated that on June 12, 1882, the insurance company insured his growing crops of wheat, oats and strawberries against loss or injury by hail to the extent of \$1,935, for an agreed

<sup>1</sup> Statement abridged. Concurring opinion of Beck, C. J., and Helm, J., omitted.



premium of \$61.03, \$3 of which were paid down, and a note for \$58.03 due and payable November 1, 1882, to the company, was executed by the plaintiff, delivered to and accepted by the defendant, and the latter issued a policy to the same effect on the same date, providing for a valuation by appraisers selected by the parties in case of partial loss, and if the sum could not be agreed upon by the parties themselves; that a loss occurred on June 19, 1882; that proofs were immediately put in showing the loss to be \$1,500; that the parties disagreed as to this, whereupon appraisers were chosen, who fixed the loss at \$1,500, and reported the same to the company, which refused to pay according to the terms of the policy. Suit was then brought; the company answering, denied any liability upon the ground that its articles of association (which had been duly filed with the secretary of state, and also in the clerk's office of the county where the property insured was located, as required by law), authorized it to insure "against loss or casualty by fire or lightning," only, and tendered back the \$3 paid and the note given by the plaintiff, who refused them. The plaintiff demurred to this answer; the demurrer was sustained, and the company electing to stand upon its answer, the damages were assessed by a jury at \$1,265.50, and judgment for that sum was given. The appellee brought error for sustaining the demurrer and giving judgment for plaintiff. The sole question is whether the company can avail itself of the plea of *ultra vires* as a defense.]

STONE, J. \* \* \* The authorities cited on both sides of the case are very numerous. Questions touching the *ultra vires* of corporations have been before the courts of probably every state in some shape, and various phases of the question have been many times considered by the federal courts, while standard text-books are full of research and discussion upon the entire subject. We have examined these authorities with care, but a review of them here would be unnecessary labor, since both the English and American authorities have been collated and discussed fully in many of the leading cases cited by counsel in their briefs filed in the case. In respect to the precise question before us, there is apparently much conflict of opinion in the decisions of the courts, such conflict being in many cases apparent only, but in others squarely antagonistic. It is quite well settled as a general rule that a corporation possesses only such lawful powers as are expressly conferred by its charter, and such as are clearly incidental or impliedly requisite for carrying out the declared objects and purposes of its creation.

On the one hand, it is held by some authorities that acts of a corporation in excess of the powers limited by the foregoing rule are illegal, that any contract made in such excess of lawful authority is void and not enforceable, and that neither party to an action founded thereon is estopped to plead the *ultra vires* of the contract in bar of such action.

On the other hand, it has come to be the settled doctrine of several states that a corporation may be estopped to deny its authority to enter

into a contract which has been executed, and from which it has derived the benefit which it thereby sought. There seems to be a growing tendency to this doctrine in modern decisions in this country, and it is also supported by the authority of English cases.

As is said in *Parish v. Wheeler*, 22 N. Y. 494, a leading case upon this subject in the United States: "The executed dealings of corporations must be allowed to stand for and against both parties where the plainest rules of good faith require."

Mr. Waterman, in his late excellent treatise upon the specific performance of contracts, says that it is now settled that a corporation can not avail itself of the defense of *ultra vires*, when the contract has been in good faith fully performed by the other party, and the corporation has had the full benefit of the performance and of the contract. Section 226. So if the other party has had the benefit of a contract fully performed by the corporation, he will not be heard to object that the contract and performance were not within the legitimate powers of the corporation.

In the case before us the contract, as made by the parties, appears to have been fully executed on the part of the appellee, so far as his right of action when brought was affected by it. He had paid a small portion of money on the amount of the premium agreed to be paid, and had given a promissory note for the balance. This was all he had agreed to do; all that had been exacted of him by the insurance company, and this he had performed. It matters not that the note had not been paid, for it was not due when his right of action accrued and when he brought his suit.

It is not contended that the payment of the note was a condition precedent to his right of action against the company, since, at the time of bringing the action the note lacked two months of maturity, and there was nothing to be done or performed by him under the contract. The performance already made by the appellee had been accepted by the appellant company, and, so far as it was concerned, the execution of the note was the same as a cash payment in full of the amount; the company had the benefit thereof. It is argued on behalf of the appellant that the courts ought in all such cases to sustain the defense of *ultra vires*, here interposed, on the ground of public policy; that the public which confers the corporate powers upon such companies has an interest in the protection of innocent stockholders and creditors of such companies by confining the exercise of corporate powers strictly within their authorized limits, and this is given in the books as the chief reason for the rule of decision in the cases which sustain the defense of *ultra vires*.

That the public has such an interest is quite true, but whether to afford such protection the defense of *ultra vires* is alway necessary in such cases is another thing. Stockholders are but one portion of the public; another portion, with equal rights of protection, is that with whom these multiform corporations deal in the daily exercise of their assumed powers. And it seems illogical to assume that the interests

of the public would be best subserved by a public policy which will allow a corporation, any more than an individual, to violate the principles of common honesty and claim exemption from the obligation of its contracts by pleading its own wrong-doing. Such policy would rather seem to offer a premium for dishonest dealing.

Besides, both the state which grants these corporate powers, and the stockholders for whose benefit such powers are exercised, have their remedies, the former by interfering to revoke the charter, and the latter by an action to restrain the unauthorized undertakings. While courts are inclined to maintain with vigor the limitations of corporate actions, whenever it is a question of restraining the corporation in advance from passing beyond the boundaries of their charters, they are equally inclined, on the other hand, to enforce against them contracts, though *ultra vires*, of which they have received the benefit. If the other party proceeds to the performance of the contract, expending his money and labor in the production of values which the corporation appropriates, such corporation will not be excused on the plea that the contract was beyond its powers. *Bradley v. Ballard*, 55 Ill. 413, 8 Am. Rep. 656.

Corporations have the capacity to do wrong, and may overstep the limits placed by the law to their powers, and when they violate their charters in this respect their acts are illegal, but not necessarily void. *Bissell v. Mich., etc., R. R. Co.*, 22 N. Y. 258.

The plea of *ultra vires* is not to be understood as an absolute and peremptory defense in all cases of excess of power without regard to other circumstances and considerations. The plea is not to be entertained where its allowance will do great wrong to innocent third persons. *Bissell v. Mich., etc., R. R. Co.*, 22 N. Y. 258. Where a certain act is prohibited by statute, its performance is to be held void because such is the legislative will. So where the consideration of a contract is by law illegal, as where the cause of action arises *ex turpe*. But where the act is not wrong *per se*, where the contract is for a lawful purpose in itself, has been entered into with good faith, and fairly executed by the party who seeks to enforce it, we must assent to the doctrine of those authorities which hold that the excess of the corporate powers of the contracting party which has received the benefit of the contract is an unconscionable defense, which may not be set up to exempt from liability the party so pleading it. And such, we think, is the case before us.

The answer of the insurance company does not deny the averment in the complaint that the company "was doing business in Larimer county, in the state of Colorado, as a general fire and hail insurance company." It does not deny that it entered into the contract of insurance with the appellee in manner and form as alleged in said complaint, nor that the contract was executed as averred. The sole defense upon which the appellant company relies here is its want of authority to insure against hail. By offering to insure the property of appellee against damage by hail, and by entering into the contract of insurance therefor, it claimed to possess the power so to do. It

took the appellee's money and assumed the risk and obligation of paying the damage, much or little, that might occur, or of having nothing at all to pay, if the contingency of damage should not happen within the time covered by the policy.

A loss having occurred, the company seeks exemption from the obligation it entered into by denying that it had any authority to do what it asserted the right to do when it voluntarily assumed the undertaking.

We are aware that the courts have been very slow to concede that a defendant setting up as a defense the *ultra vires* of a contract, where said contract was clearly not authorized, should be held liable on the contract, since this would appear to sustain the enforcement of an unauthorized contract, and therefore the cases show that whenever the courts could avoid this seeming inconsistency by resting the recovery upon some other ground, they have done so. This has often led to equal inconsistency in other directions. The true ground would seem to be that of equitable estoppel, whereby the defendant is not permitted to rely upon or show the invalidity of the contract. In such case, the contract is assumed by the court to be valid, the party seeking to avoid it not being permitted to attack its character in this respect.

The point was strongly insisted upon by counsel for appellant in argument, that one dealing with a corporation is bound to know the extent of its powers to contract, that the corporate name itself indicates the scope of its business, and the record of its charter or articles of incorporation furnishes notice of the extent and limitation of its corporate powers and authority to contract.

While as a general proposition this is true, yet it must be conceded that this constructive notice is of a very vague and shadowy character. Every one may have access to the statutes of the states affecting companies incorporated thereunder, and to their articles of incorporation, but to impute a knowledge of the probable construction the courts would put upon these statutes and articles of incorporation to determine questions raised upon a given contract proposed, is carrying the doctrine of notice to an extent which can only be denominated preposterous. It was in answer to the same point that Chief Justice Comstock observed, in his opinion in a leading case upon this question, that "a traveler from New York to Mississippi can hardly be required to furnish himself with the charters of all the railroads on his route, or to study a treatise on the law of corporations." *Bissell v. M. S. & N. I. R. R. Co.*, 22 N. Y. 258. It was urged in argument on behalf of appellant that the state, which created these corporations for public good, has such an interest in their existence and perpetuity that public policy should be interposed to keep them within the legitimate exercise of their powers. This may be true to a certain extent, and the state may interpose to revoke their charters for an abuse thereof; but we take it that it is no more the public policy of the state to protect the business of private corporations than that of its individual citizens; and to invoke public policy in a case like

the one at bar, in order to prevent a corporation from doing wrong, by punishing the other party, would differ little from asking a court, on the ground of public policy, to prevent the obtaining money or goods through false pretenses by holding that the party defrauded should be punished by the loss of his money or goods.

While such wrong may be prevented by interference on the part of the state, or stockholders of the company, it can not well be said that to cure the evil it is necessary in every case to exempt the company from the liability of its unauthorized engagements.

The principle of estoppel by conduct is the same principle which is applied by courts in holding that the statute of frauds by which, under the general rule, a contract would be void, is never to be used for the protection of a fraud.

The essential elements of an estoppel by conduct are laid down by this court, in *Griffith v. Wright*, 6 Colo. 248, to be that: 1. There must have been a representation or concealment of material facts. 2. The representations must have been made with knowledge of the facts, unless the party representing was bound to know them, or that ignorance thereof was the result of gross negligence. 3. The party to whom it was made must have been ignorant of the truth of the matter. 4. It must have been made with the intention that the other party should act upon it, but gross and culpable negligence on the part of the party sought to be estopped, the effect of which is to make a fraud on the party setting up the estoppel, supplies the place of intent. 5. The other party must have been induced to act upon it. The case before us seems to be fairly brought within the foregoing rules and definitions. The insurance company, through its agent, not only concealed the want of authority to insure against hail, which it now sets up, but its open notorious acts in soliciting policies of this character throughout the country, impliedly held out and represented its authority for such business.

Such agent was certainly bound to know the extent of the authority of the company he represented, and if his acts in the premises were not done with full knowledge of the facts, his ignorance in this respect was gross and culpable negligence.

That the appellee was ignorant of the truth of the matter of want of authority in the company is not denied by the appellant company, except by an inference which, it is argued, is to be drawn, that the articles of incorporation, and the record thereof furnished constructive notice of the extent of authority of said company. But it seems to us that such inference is rebutted by the presumption fairly arising from the nature of the transaction, that the appellee would not have paid his money for the performance of a promise which he knew was void; that its performance could not be enforced, and that his money would be utterly thrown away.

That the offer of the appellant to insure, and the representations made to induce the appellee to enter into the contract of insurance, were made with the intent that the appellee should act thereon, is self-evident from the nature of the transaction, and the acceptance by



the appellee of the offer so made by the appellant; and that the appellee was induced to act upon the offer and representations so made is equally apparent, for the act was an obvious sequence of the inducement.

It was strenuously contended by counsel for appellant in the oral argument of this case, that whether the contract in a case of this kind is executed or not is immaterial; that the true grounds of liability depend upon, and should be placed upon, the fact of whether the elements of estoppel exist; whether the conduct of one party has been such as that the other party would be defrauded or injured thereby unless the contract should be enforced.

However this may be in respect to the other cases, or as a general rule, we are quite willing to assent to this view in the particular case before us, and to rest our decision upon the ground of estoppel by the conduct of the appellant company.

We do not say that the directors or acting officers of such company may act in excess of their legitimate powers against the interests and contrary to the will of the stockholders of such company, but while admitting the excess of proper authority, we think, on principle and the weight of modern decisions, that if the stockholders, whose business it is to see that their own managing officers act within the proper scope of their powers, either expressly, or by silence impliedly, assent to acts done on their behalf in excess of authority, they should be held estopped to deny that such acts were authorized.

The appellant company here offered to pay back the money and return or cancel the note given for the policy, and counsel urgently contended that this is all that legally can or rightfully ought to be exacted. This would not place the appellee *in statu quo*. Every insurance company would be ready and willing to do that much after the loss had occurred, on condition of exemption from payment of the loss. The damage to appellee is the loss of his crops, against which the appellant undertook to secure him. After the loss it was far too late for appellee to insure in another company having unquestioned authority to insure against such loss.

We, therefore, conclude that since the contract of insurance, though it may have been beyond the scope of the proper object and purposes of the company as expressed and conferred by their articles of incorporation, was neither by statute nor by their charter expressly forbidden, nor in its nature illegal or improper, and since the conduct of the company in soliciting the insurance and entering into the contract therefor under the circumstances disclosed by this case was such that to exempt it from its engagements thereunder would result in injuring and defrauding the appellee, who in good faith dealt with the company under the belief of its rightful authority in the premises, the defense of the appellant company interposed against its liability on the contract is inequitable, unconscionable, and should not be allowed.

It is admitted that a contract is not enforceable when prohibited by statute; when not so prohibited, however, and when not illegal or immoral in its nature, nor contrary to sound public policy, a contract,



even *ultra vires*, may be enforced, when, under the circumstances of its execution, every consideration of justice requires it. This is the ground of decision in most of the cases relied upon by the appellee in the case.

As is said by the supreme court of the United States in the case of *Zabriskie v. Cl., Col. & Cin. R. R. Co. et al.*, 23 How. 400: "A corporation, quite as much as an individual, is held to a careful adherence to truth in their dealings with mankind, and can not, by their representations or silence, involve others in onerous engagements, and then defeat the calculations and claim their own conduct has superinduced."

Among the many authorities examined in support of our views in this case, we cite the following: *Parish v. Wheeler*, 22 N. Y. 503; *Bissell v. M. S., etc., R. R. Co.*, 22 N. Y. 258; *Bradley v. Ballard*, 55 Ill. 413; *Whitney Arms Co. v. Barlow*, 63 N. Y. 69; *Darst v. Gale*, 83 Ill. 141; *State B'd of Agr. v. Citizens' Street R'y Co.*, 47 Ind. 407; *Oil Cr., etc., R. R. Co. v. Pa. Trans. Co.*, 83 Pa. St. 166; *Argenti v. City of San Francisco*, 16 Cal. 255; *State of Ind. v. Woram*, 6 Hill 37; *Converse v. Norwich & N. Y. Trans. Co.*, 33 Conn. 180, modifying the doctrine in the case of *Hood v. N. Y. & N. H. R. R. Co.*, 22 Conn. 502; *Chicago Build. Soc. v. Crowell*, 65 Ill. 453; *Ward v. Johnson et al.*, 95 Ill. 215-240; *Zabriskie v. Cl., Col. & Cin. R. R. Co. et al.*, 23 How. 398-401; *Hitchcock v. Galveston*, 96 U. S. 341-351; *Nat'l Bank v. Matthews*, 98 U. S. 621; *Manville v. Belden M. Co. (McCrary, J., U. S. Cir. Ct.)*, 3 Colo. Law 558; *Green's Brice's Ultra Vires*, 371, and cases cited; *Sedgwick's Stat. and Const. L.*, 90; *Waterman's Specific Perf. Cont.*, cited *supra*.

*Affirmed. Accord:* 1902, *Vought v. Eastern Bldg., etc., Assn.*, 172 N. Y. 508, 92 Am. St. R. 761.

### Sec. 373. (d) Specific performance.

See *Case v. Kelly*, 133 U. S. 21, *supra*, p. 1012.

### Sec. 374. (e) Leases.

#### (1) Recovery of damages for breach.

See *Thomas v. R. R. Co.*, 101 U. S. 71, *supra*, p. 915.

*Note.* See article by E. A. Harriman, in 14 Harv. Law Rev. (Jan'y, 1901), p. 332.

### Sec. 375. Same.

#### (2) Recovery of unpaid rentals under the contract.

See *Central Trans. Co. v. Pullman's Palace Car Co.*, 139 U. S. 24, *supra*, p. 1178. *Oregon Ry. Co. v. Oregonian Ry.*, 130 U. S. 1, *supra*, p. 429. *Contra*, 1896, *Bath Gas Light Co. v. Claffy*, 151 N. Y. 24.

## Sec. 376. Same.

## (3) Recovery for use of property.

See Brunswick Gas L. Co. v. N. G. F., etc., Co., 85 Maine 532, *supra*, p. 1071. *Contra*, 1896, Bath Gas Light Co. v. Claffy, 151 N. Y. 24.

## Sec. 377. Same.

## (4) Re-entry.

AMERICAN UNION TELEGRAPH CO. v. UNION PACIFIC RAILROAD CO.<sup>1</sup>

1880. IN THE UNITED STATES CIRCUIT COURT, DISTRICT OF NEBRASKA. 1 McCrary Rep. 188-208.

[Suit by the telegraph company to enjoin the railroad company from disregarding a certain contract of lease under which the plaintiff had been in the possession and operation of the telegraph line in question; the line was built by the railroad company under its authority from congress "to construct, maintain and enjoy a continuous line of railroad and telegraph." In 1866 the railroad company, in consideration of the transfer to it of 17,800 shares of the stock of the telegraph company, leased its telegraph line to the telegraph company for the whole period of the railroad charter, or any renewals thereof, upon condition that the telegraph company would perform all the public and private duties imposed upon the railroad company, in respect to the telegraph line, by its charter or the laws of the United States. In 1880 the railroad company, of its own motion, undertook to rescind the lease, and take possession of the line and operate it to the exclusion of the telegraph company, and to do this cut the wires running to plaintiff's office.]

McCrary, Circuit Judge. \* \* \* (After holding that the lease by the railroad company was *ultra vires* proceeds:)

This brings me to the question whether the railroad company can be permitted to rescind the contract, and on its own motion to take possession of the lines, offices and property, without first returning the consideration received therefor from the plaintiff. As already stated, the railroad company received from the plaintiff, in payment for the property and rights agreed to be transferred by said contracts, 17,800 shares of the capital stock of the corporation plaintiff. There is a dispute as to the value of the stock, but I believe it is not placed by any one of the deponents at less than \$150,000, while some of them place it at a much higher sum.

<sup>1</sup> Statement much abridged, and only that part of the opinion relating to re-taking possession of the leased premises is given.

No case has been cited in argument, nor have I been able to find one which holds that a court of equity, having jurisdiction of the parties to "and the subject-matter of" an illegal contract, should require one of such parties to give up what he has received under it, without requiring the other to do the same. Many cases hold that a corporation which has made a contract *ultra vires*, which has not been fully performed, is not estopped from pleading its own want of power when sued upon such contract; but that doctrine does not apply to a case where a party comes into a court of equity, and, while retaining all that he has received upon such a contract, asks to be permitted to retake what he has parted with under it. I take it there is nothing in the law, as there is certainly nothing in the principles of equity, to estop the court from saying that the obligation to return the property transferred under these contracts is mutual, and shall not be enforced against one of the parties without being at the same time enforced against the other. As the parties and the subject-matter are now before the court, it is the duty of the court, as far as possible, to place them *in statu quo*. It has been held that even in cases at common law, a contract *ultra vires*, made between a corporation and another person, and under which the corporation has received value, which it retains, will be so far enforced as to estop the corporation from refusing payment on the ground of its own want of power. *Bradley v. Bullard*, 55 Ill. 417.

And in the case of *Thomas v. West Jersey R. Co.*, 101 U. S. 71, already quoted from at length, Mr. Justice Miller, upon this point, says: "There can be no question that, in many instances, where an invalid contract, which the party to it might have avoided or refused to perform, has been fully performed on both sides, whereby money has been paid or property changed hands, the courts have refused to sustain an action for the recovery of the property or the money so transferred. And in regard to corporations, the rule has been well laid down by Chief Justice Comstock, in *Parish v. Wheeler*, 22 N. Y. 404, that the executed dealings of corporations must be allowed to stand for and against both parties when the plainest rules of good faith require it. But what is sought in the case before us, is the enforcement of the unexecuted part of this agreement. So far as it has been executed, namely, the four or five years of action under it, the accounts have been adjusted and each party has received what he was entitled to by its terms."

The present case, like the New Jersey case in which these remarks were made, is one on which the contract has been executed in part, but it differs from that case in one important particular. In the New Jersey case the court say that, "so far as it (the contract in question) has been executed, namely, the four or five years of action under it, the accounts have been adjusted, and *each party has received what he was entitled to by its terms.*"

If that case had been in equity, and it had appeared that the railroad company had received in advance the full consideration for the whole term of the lease, which it retained, while asking to be relieved

from the contract, I have no doubt the court would have said: "You must come into this tribunal with clean hands; you must do equity before you can seek the aid of a court of conscience."

The contention of the railroad company is that it should be permitted to take possession of the property in controversy without process or legal proceedings. While I am clear that the contracts under which the property is held by plaintiff are *ultra vires*, there is a dispute upon that subject, and such a dispute as in my judgment can not be determined by the railroad company of its own motion.

The right of rescission does not justify the railroad company in taking possession except by lawful means. The plaintiff has a right to be heard upon issue joined in a proper proceeding before being ejected. The present question is not whether the contracts should be rescinded and the property restored to the railroad company, but whether this should be done by the railroad company upon its own motion, and in a way to deprive the plaintiff not only of a hearing in the regular course of this court, but also deprive it of the right of appeal.

It is one thing for me to hold that the contracts are, in my judgment, *ultra vires*, and quite another to say to the railroad company, "You may turn the plaintiff out and take possession without giving it a day in court."

An injunction will often be granted to restrain a party from deciding for himself a question involving controverted rights, and to compel him to resort to the courts, and this without regard to the absolute merits of the controversy. It is enough that there is a controversy to justify a court of equity in directing that it be settled by legal proceedings. *Eckelkamp v. Schrader*, 45 Mo. 505; *Varick v. New York*, 4 Johns. Ch. 53; *Dudley v. Trustees*, 12 B. Mon. 610; *Farmers v. Reno*, 53 Pa. St. 224; *Lansing v. Steamboat Co.*, 7 Johns. Ch. 162.

The principle settled by these and many other cases is that a party who is in actual possession of property, claiming under color of title, is not to be ousted, except by the means provided by law, and such a possession the court will protect by injunction from disturbance by any other means. For this reason, therefore, as well as upon the grounds above stated, I am clearly of the opinion that the railway company can not be permitted to oust the plaintiff from possession without process.

The injunction, heretofore granted, will be so far modified as to make it clear that the railroad company is at liberty to institute legal proceedings, either by cross-bill in this case or otherwise, to cancel and set aside the said contracts upon a return of the consideration, and to settle and adjust, upon principles of equity, the accounts between the parties.

Compare, 1880, *Central Branch U. P. R. R. v. West. Union Tel. Co.*, 1 McCrary 551; 1888, *Mallory v. Hanaur Oil Works*, 86 Tenn. 598, *supra*, p. 957.

**Sec. 378. Same.**

**(5) Recovery of possession in equity.**

**ST. LOUIS, V. & T. H. R. CO. v. TERRE HAUTE & I. R. CO.<sup>1</sup>**

**1892. IN THE UNITED STATES SUPREME COURT. 145 U. S. 393,  
12 Sup. Ct. 953.**

Appeal from the circuit court of the United States for the southern district of Illinois.

[Bill in equity, filed in 1887 by the St. Louis Company, a corporation of Illinois, against the Terre Haute Company, a corporation of Indiana, to set aside and cancel a conveyance of the plaintiff's railroad. February 10, 1868, the plaintiff and the defendant executed a pretended lease of the plaintiff's railroad, property and franchises to the defendant for 999 years, the defendant retaining sixty-five per cent. of the gross receipts, and the rest to be applied to the payment of interest on the mortgage bonds, and any surplus paid to the plaintiff. On the completion of the plaintiff's road, the defendant took possession of and had ever since operated it, and had received, in tolls and otherwise, more than \$21,600,000. The bill prayed for a cancellation and surrender of the lease, for a return of the railroad and other property held under it, for an injunction against disturbing the plaintiff in the possession and control thereof, and for an account of the sums which the defendant had received, or with due diligence might have received, from the use and operation of the railroad and property. The defendant demurred, the court sustained the demurrer, dismissed the bill, and the plaintiff appealed to this court.]

**MR. JUSTICE GRAY.** The object of this suit between two railroad corporations, as stated in the bill, is to have a contract, by which the plaintiff transferred its railroad and equipment, as well as its franchise to maintain and operate the road, to the defendant for a term of 999 years, set aside and canceled, as beyond the corporate powers of one or both of the parties. \* \* \*

By this contract one railroad corporation undertook to transfer its whole railroad and equipment, and its privilege and franchise to maintain and operate the road, to another railroad corporation for a term of 999 years, in consideration of the payment from time to time by the latter to the former of a certain portion of the gross receipts. This was, in substance and effect, a lease of the railroad and franchise for a term of almost a thousand years, and was a contract which neither corporation had the lawful power to enter into, unless expressly authorized by the state which created it, and which, if beyond the scope of the lawful powers of either corporation, was unlawful and wholly void, could not be ratified or validated by either or both, and would support no action or suit by either against the other. *Thomas v. Railroad Co.*, 101 U. S. 71; *Pennsylvania R. Co. v. St.*

<sup>1</sup> Statement abridged; arguments and part of opinion omitted.

Louis, A. & T. H. R. Co., 118 U. S. 290, 630, 6 Sup. Ct. Rep. 1094, and 7 Sup. Ct. Rep. 24; Oregon Ry. & Nav. Co. v. Oregonian Ry. Co., 130 U. S. 1, 9 Sup. Ct. Rep. 409; Central Transp. Co. v. Pullman's Palace Car Co., 139 U. S. 24, 11 Sup. Ct. Rep. 478.

Upon the question whether this contract was *ultra vires* of either corporation, this case can not be distinguished in principle from Pennsylvania R. Co. v. St. Louis, A. & T. H. R. Co., above cited.

[After discussing the capacity of the plaintiff to lease its road.] \* \*

It is unnecessary, however, to express a definitive opinion upon the question whether the contract between these parties was beyond the corporate powers of the plaintiff, because, as is established by the decisions of this court, already cited, a contract beyond the corporate powers of either party is as invalid as if beyond the corporate powers of both, and the contract now in question was clearly beyond the corporate powers of the defendant.

The case in this respect is governed by the direct adjudication of this court in the case of Pennsylvania R. Co. v. St. Louis, A. & T. H. R. Co., above cited. \* \* \*

It may therefore be assumed, as contended by the plaintiff, that the contract in question was *ultra vires* of the defendant, and therefore did not bind either party, and neither party could have maintained a suit upon it, at law or in equity, against the other.

It does not, however, follow that this suit to set aside and cancel the contract can be maintained. If it can, it is somewhat remarkable that, in the repeated and full discussions which the doctrine of *ultra vires* has undergone in the English courts within the last fifty years, no attempt has been made to bring a suit like this. The only cases cited in the elaborate briefs for the plaintiff, or which have come to our notice, approaching this in their circumstances, are in American courts not of last resort, and present no sufficient reasons for maintaining this suit. Auburn Academy v. Strong, Hopk. Ch. 278; Atlantic & P. Tel. Co. v. Union Pac. Ry. Co., 1 McCrary 541, 1 Fed. Rep. 745; Western Union Tel. Co. v. St. Joseph & W. Ry. Co., 1 McCrary 565, 3 Fed. Rep. 430; Union Bridge Co. v. Troy & L. R. Co., 7 Lans. 240; Railway Co. v. Simpson, 21 Fed. Rep. 533.

The English cases relied on by the plaintiff were either suits to set aside marriage brokerage bonds, as in Drury v. Hooke, 1 Vern. 412, and Smith v. Bruning, 2 Vern. 392, *nom.* Goldsmith v. Bruning, 1 Eq. Cas. Abr. 89; or to recover back money paid for the purchase, without leave of the crown, of a commission in the military or naval service, as in Morris v. McCulloch, Amb. 433, 2 Eden 190. Those cases have sometimes been justified upon the ground that, the agreement being against the policy of the law, the relief was given to the public through the party. Debenham v. Ox, 1 Ves. Sr. 276; St. John v. St. John, 11 Ves. 526, 536; Cone v. Russell, 48 N. J. Eq. 208, 21 Atl. Rep. 847. But Sir William Grant explained them as proceeding upon the ground that the plaintiff was less guilty than the defendant. Osborne v. Williams, 18 Ves. 379, 382. And Morris



v. McCulloch can hardly be reconciled with his decision in Thomson v. Thomson, 7 Ves. 470, or with the current of later authorities.

The general rule, in equity, as at law, is *In pari delicto potior est conditio defendentis*; and, therefore, neither party to an illegal contract will be aided by the court, whether to enforce it or to set it aside. If the contract is illegal, affirmative relief against it will not be granted, at law or in equity, unless the contract remains executory, or unless the parties are considered not in equal fault, as where the law violated is intended for the coercion of the one party and the protection of the other, or where there has been fraud or oppression on the part of the defendant. Thomas v. Richmond, 12 Wall. 349, 355; Springs Co. v. Knowlton, 103 U. S. 49; Story Eq. Jur., § 298.

While an unlawful contract, the parties to which are *in pari delicto*, remains executory, its invalidity is a defense in a court of law; and a court of equity will order its cancellation only as an equitable mode of making that defense effectual, and when necessary for that purpose. Adams Eq., 175. Consequently, it is well settled, at the present day, that a court of equity will not entertain jurisdiction to order an instrument to be delivered up and canceled, upon the ground of illegality appearing on its face, and when, therefore, there is no danger that the lapse of time may deprive the party to be charged upon it of his means of defense. Story Eq. Jur., § 700a, and cases cited. Simpson v. Howden, 3 Mylne & C. 97; Ayerst v. Jenkins, L. R. 16 Eq. 275, 282.

When the parties are *in pari delicto*, and the contract has been fully executed on the part of the plaintiff, by the conveyance of property, or by the payment of money, and has not been repudiated by the defendant, it is now equally well settled that neither a court of law nor a court of equity will assist the plaintiff to recover back the property conveyed or money paid under the contract. Thomas v. Richmond, above cited; Ayerst v. Jenkins, L. R. 16 Eq. 275, 284. For instance, property conveyed pursuant to a contract made in consideration of the compounding of a crime, and the stifling of a criminal prosecution, and therefore clearly illegal, can not be recovered back at law, nor the conveyance set aside in equity, unless obtained by such fraud or oppression on the part of the grantee that the conveyance can not be considered the voluntary act of the grantor. Worcester v. Eaton, 11 Mass. 368, and 13 Mass. 371; Atwood v. Fisk, 101 Mass. 363; Bryant v. Peck & Whipple Co., 154 Mass. 460, 28 N. E. Rep. 678; Williams v. Bayley, L. R. 1 H. L. 200; Jones v. Society [1892], 1 Ch. 173, 182, 185, 187.

In the case at bar, the contract by which the plaintiff conveyed its railroad and franchise to the defendant for a term of 999 years was beyond the defendant's corporate powers, and therefore unlawful and void, of which the plaintiff was bound to take notice. The plaintiff stood in the position of alienating the powers which it had received from the state, and the duties which it owed to the public, to another corporation, which it knew had no lawful capacity to exercise those powers or to perform those duties. If, as the plaintiff contends, the

contract was also beyond its own corporate powers, it is certainly in no better position. In either aspect of the case, the plaintiff was *in pari delicto* with the defendant. The invalidity of the contract, in view of the laws of which both parties were bound to take notice, was apparent on its face. The contract has been fully executed on the part of the plaintiff by the actual transfer of its railroad and franchise to the defendant; and the defendant has held the property, and paid the stipulated consideration from time to time, for seventeen years, and has taken no steps to rescind or repudiate the contract.

Upon this state of facts, for the reasons above stated, the plaintiff, considered as a party to the unlawful contract, has no right to invoke the assistance of a court of equity to set it aside. And so far as the plaintiff corporation can be considered as representing the stockholders, and seeking to protect their interests, it and they are barred by laches. *Harwood v. Railroad Co.*, 17 Wall. 78; *Graham v. Railway Co.*, 2 Hall & T. 450, 2 Macn. & G. 146; *Ffooks v. Railway Co.*, 1 Smale & G. 142, 164; *Gregory v. Patchett*, 11 Law T. (N. S.) 357.

This case is not like those in which the defendant, having abandoned or refused to perform the unlawful contract, has been held liable to the plaintiff, as upon an implied contract, for the value of what it had received from him, and had no right to retain. *Springs Co. v. Knowlton*, 103 U. S. 49; *Bank v. Townsend*, 139 U. S. 67, 11 Sup. Ct. Rep. 496, and cases there cited.

But the case is one in which, in the words of Mr. Justice Miller, in a case often cited in this opinion, the court will not disturb the possession of the property that has passed under the contract, but will refuse to interfere as the matter stands. *Pennsylvania R. Co. v. St. Louis, A. & T. H. R. Co.*, 118 U. S. 290, 316, 317, 6 Sup. Ct. Rep. 1094. See, also, *Union Trust Co. v. Illinois M. Ry. Co.*, 117 U. S. 434, 468, 469, 6 Sup. Ct. Rep. 809; *Central Transp. Co. v. Pullman's Palace Car Co.*, 139 U. S. 24, 56, 57, 61, 11 Sup. Ct. Rep. 478.

Decree affirmed.

Compare, 1879, *Thomas v. R. Co.*, 101 U. S. 71, *supra*, p. 915; 1884, *New Castle N. R. v. Simpson*, 21 Fed. Rep. 533; 1886, *Pennsylvania Co. v. St. L., etc., R. Co.*, 118 U. S. 290, 317; 1888, *Mallory v. Hanaur Oil Works*, 86 Tenn. 598, *supra*, p. 957; 1890, *Memphis, etc., R. Co. v. Grayson*, 88 Ala. 572; 1890, *Manchester, etc., R. Co. v. Concord Co.*, 66 N. H. 100, 49 Am. St. Rep. 582.

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## Sec. 379. Same.

### (6) Recovery of property in an action for unlawful detention.

See *Mallory v. Hanaur Oil Works*, 86 Tenn. 598, *supra*, p. 957.

*Note.* See cases cited to § 378, *supra*.

**Sec. 380. 2. Bequests in excess of amount authorized by charter ; theories :**

(a) Valid as to everybody except the state, which alone can complain in *quo warranto*, for violation of charter.

See *Farrington v. Putnam*, 90 Maine 405, *supra*, p. 1029.

Also, see *note, supra*, p. 1033.

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**Sec. 381. Same.**

(b) Void as to excess, and heirs may have set aside.

See, *In re McGraw*, 111 N. Y. 66, *supra*, p. 1034.

Also, see *note, supra*, p. 1039.

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**Sec. 382. 3. Torts.**

See *Nims v. Mt. Hermon School*, 160 Mass. 177, 39 Am. St. Rep. 467, 22 L. R. A. 364, *infra*, p. 1268; *Bissell v. R. R. Co.*, 22 N. Y. 259, per *Selden, J.*, *supra*, p. 1191.

*Note.* By the weight of authority, a corporation is liable for a tort committed by its officers or agents, in an *ultra vires* transaction authorized by the corporate management: 1858, *P. W. & B. R. v. Quigley*, 21 How. (U. S.) 202; 1859, *Taylor v. Water Power Co.*, 12 Gray 415; 1865, *N. Y. & N. H. R. Co. v. Schuyler*, 34 N. Y. 30; 1867, *Maynard v. F. F. Ins. Co.*, 34 Cal. 48; 1869, *Buffer v. T. & B. R.*, 40 N. Y. 168; 1871, *Hutchinson v. West, etc., R.*, 6 Heisk. 634; 1878, *Railroad Co. v. Chappell*, 61 Ala. 527; 1879, *First Nat'l Bk. v. Graham*, 100 U. S. 699; 1881, *Alexander v. Relfe*, 74 Mo. 495; 1884, *Cent. R. & B. Co. v. Smith*, 76 Ala. 572, 52 Am. Rep. 353; 1885, *L. E. & W. R. v. Haring*, 47 N. J. L. 137; 1885, *Gruber v. Wash. & J. R. Co.*, 92 N. C. 1; 1885, *Salt Lake City v. Hollister*, 118 U. S. 256; 1886, *Denver & R. G. R. Co. v. Harris*, 122 U. S. 597; 1887, *Hussey v. N. S. R. Co.*, 98 N. C. 34; 1888, *Sherman v. Printing Co.*, 29 Mo. App. 31; 1889, *Fogg v. B. & L. R. Co.*, 148 Mass. 513; 1896, *Johnson Fife Hat Co. v. Nat'l Bk.*, 4 Okla. 17, 44 Pac. Rep. 192; 1898, *Minn. Trust Co. v. Menage*, 73 Minn. 441; 1899, *Zinc Carbonate Co. v. Bank*, 103 Wis. 125, 74 Am. St. Rep. 845.

*Contra.* See *Orr v. Bank of U. S.*, 1 Ham. (Ohio) 28; 1852, *Childs v. Bank of Mo.*, 17 Mo. 213; 1853, *Hood v. N. Y. & N. H. R.*, 22 Conn. 501; 1874, *Gillett v. Mo. Valley R. Co.*, 55 Mo. 315, 17 Am. Rep. 653; 1875, *Weckler v. First Nat'l Bk.*, 42 Md. 581; 1878, *Haag v. Commrs.*, 60 Ind. 511, 28 Am. Rep. 654; 1885, *Gunn v. Cent. R., etc., Co.*, 74 Ga. 509; 1887, *Bathe v. Decatur Co. Ag. Soc.*, 73 Iowa 11.

## ARTICLE V. WHO CAN COMPLAIN OF ULTRA VIRES ACTS?

## Sec. 383. 1. The state:

See *People v. Pullman's Pal. Car Co.*, 175 Ill. 125, *supra*, p. 926; *People v. N. River Sugar Ref. Co.*, 121 N. Y. 582, *supra*, p. 100; *People v. Chicago Gas T. Co.*, 130 Ill. 303, *supra*, p. 1054; *People v. Utica Ins. Co.*, 15 Johns. (N. Y.) 358, *supra*, p. 1113; *Commw. v. N. Y., etc., R. R. Co.*, 132 Pa. St. 591, *supra*, p. 1014; also, *infra*, *Relations of the Corporation to the State*, p. 1294 *et seq.*; and § 380, *supra*.

## Sec. 384. 2. The parties.

See, *supra*, Art. iv, §§ 365-382.

## Sec. 385. 3. Shareholders.

See *Dodge v. Woolsey*, 18 How. 331, *supra*, p. 88; *Tompkinson v. S. E. Ry. Co.*, L. R. 35 Ch. D. 675, *infra*, p. 1715; *Smith v. Hurd*, 12 Metc. 371, *infra*, p. 1706; *Hawes v. Oakland*, 104 U. S. 450, *infra*, p. 1716; *Russell v. Wakefield W. W. Co.*, L. R. 20 Eq. Cas. 474, *infra*, p. 1709; *Bronson v. La Crosse & M. R. R. Co.*, 2 Wall. 283, *infra*, p. 1713.

## Sec. 386. 4. Creditors.

See *Dexter Sav. Bk. v. Friend*, 90 Fed. Rep. 703, *infra*, p. 1790; *Pond v. Framingham & L. R. Co.*, 130 Mass. 194, *infra*, p. 1808; *Graham v. R. R. Co.*, 102 U. S. 148, *infra*, p. 1809; *Wood v. Dummer*, 3 Mason 308, *infra*, p. 1847; *Kearns v. Leaf*, 1 H. & M. 681, *infra*, p. 1862; *Foster v. Borax Co.*, 80 L. T. R. 461, *infra*, p. 1863; *Lothrop v. Stedmen*, 42 Conn. 583, *infra*, p. 1865; *Cole v. Miller-ton Iron Co.*, 133 N. Y. 164, *infra*, p. 1866.

## Sec. 387. 5. Third parties.

THE STOCKPORT DISTRICT WATER-WORKS COMPANY v. THE  
MAYOR, ETC., OF MANCHESTER, ET AL.<sup>1</sup>

1863. IN THE ENGLISH COURT OF CHANCERY. 9 Jurist N. S.  
266-7.

[Bill by the Stockport District Water-Works Company to enjoin the city of Manchester and the S. W. Co. from carrying out a certain con-

<sup>1</sup> Statement abridged; only part of opinion given.

tract entered into and alleged to be *ultra vires* both corporations. The S. W. Co. were authorized to supply the town of Stockport with water taken from the river Mersey at a certain place, the city of Manchester was authorized to supply itself with water from another source, and the plaintiff was authorized also to supply the town of Stockport with water within certain limits. The bill alleged that the city of Manchester and the S. W. Co. had entered into agreement for the purpose and were about to make a junction of their pipes in such a way that the S. W. Co. could obtain part of its supply from the city's pipes; this was alleged to be beyond the legal powers of either party; that the S. W. Co. had no right to obtain water from that source, and the city no authority to furnish water to Stockport; that the same, if carried out, would prejudice the rights of the plaintiff, and it asked to have the contract annulled and the parties enjoined. The lower court sustained a demurrer to the bill.]

LORD CHANCELLOR (WESTBURY). \* \* \* (After holding that the contract probably was *ultra vires* both parties.)

I can not see any private right which this incorporated Stockport Company has in this matter. I do not see how the overleaping of their limits by the Manchester corporation inflicts any amount of private injury upon the plaintiffs, so as to entitle them to seek redress in a court of justice. The legislature has in a variety of cases pointed out that which the principles of this court had already established—namely, that where an act of parliament is perverted to purposes not warranted by any person deriving rights under it, this court would restrain all excesses or transgressions of the legislative enactment. There is no difficulty, therefore, in defining the course of action for the purpose of restraining the conduct complained of, so far as that conduct is an injury to the public, or so far as the conduct affects individuals, to whom the Manchester corporation is properly responsible. But to the plaintiffs they are certainly not responsible. The plaintiffs have no interest in their action, so as to maintain a complaint against them. The plaintiffs are not qualified to represent the rights and interests of the public; and in one of these two capacities the bill of the plaintiffs, if it can be maintained, must be supported. In neither capacity do I think that the plaintiffs are entitled to call upon the court for relief. The plaintiffs, in point of fact, would, if they succeeded, have this consequence secured to them, that their own trade might possibly be benefited at the expense of their competitors. The people of Stockport might incur a very serious loss, because there would be a monopoly established in one company, which would have the power then of exacting the highest rates allowed by their acts of parliament; whereas, if the existing state of things is permitted to continue, that would not be the result. Now, supposing the plaintiffs applied to the attorney-general for the purpose of inducing him to file an information, probably that circumstance would be a very proper consideration for the attorney-general; and those are a few of the reasons which might be assigned, showing how desirable it is not to allow any private individual to usurp the right of representing the

public interest. The only arguments which I am disposed to accept from those which I have heard to-day are arguments founded upon the public interest, and the general advantage of restraining an incorporated company within its proper sphere of action. But, in the present case, the transgression of those limits inflicts no private wrong upon these plaintiffs; and although the plaintiffs, in common with the rest of the public, might be interested in the larger view of the question, yet the constitution of the country has wisely intrusted the privilege with a public officer, and has not allowed it to be usurped by a private individual. I must, therefore, allow the demurrer, confirm the order and dismiss the petition for rehearing, with costs.

*Note.* Accord: 1893, *Southern Pacific Co. v. United States*, 28 Ct. of Cl. Rep. 77; 1896, *The Illinois, etc., Bank v. Pacific R. Co.*, 115 Cal. 287, 49 Pac. Rep. 196; 1900, *Burke L. & L. S. Co. v. Wells, F. Co.*, — Idaho —, 60 Pac. Rep. 87.



## TITLE IV. GENERAL DUTIES AND LIABILITIES.

### CHAPTER 15.

#### LIABILITIES OTHER THAN UPON CONTRACTS.

##### ARTICLE I. TORTS.

#### Sec. 388. (1) Conversion.

#### YARBOROUGH ET AL. V. THE GOVERNOR & CO. OF THE BANK OF ENGLAND.<sup>1</sup>

1812. IN THE KING'S BENCH. 16 East's Reports 6-12.

[The plaintiffs declared in trover against the corporation of the governor and company of the Bank of England, for three promissory notes of the Bank of England, payable on demand, each for £100, describing them by their dates and numbers; to which the defendants pleaded the general issue. Verdict for plaintiff, and motion to arrest judgment.]

LORD ELLENBOROUGH, C. J. In this case, which was argued on Saturday, the only question was whether an action of trover is maintainable against a body corporate; in other words, whether a corporation can be guilty of a trespass or a tort. As a corporation they can do no act, not even affix their corporate seal to a deed, but through the instrumentality and agency of others; they can not, as a corporation, be subject to a *capias* or *exigent* (the process in trespass), because the remedies which attach upon living persons can not be applied to bodies merely politic and of an impersonal nature. But wherever they can competently do or order any act to be done on their behalf, which, as by their common seal they may do, they are liable to the consequences of such act, if it be of a tortious nature, and to the prejudice of others.

A corporation having the return of writs, or to which any writ, or a mandamus, for instance, is directed, is liable eventually to an action for a false return. The case of *Argent v. The Dean and Chapter of St. Paul's*, in this court, about the year 1781, was an action for a false return to a mandamus respecting an election to a verger's place in that cathedral, and no objection was made that the action would not lie. *Vidian's Entries*, p. 1, is an action for a false return against the mayor and commonalty of the city of Canterbury, for a false return to a writ of mandamus to restore an alderman to his precedence of place, etc. It states the mayor and corporation as *attached* to answer, and the return as falsely and *maliciously* made. The instances of actions against corporations for false returns to writs of mandamus,

<sup>1</sup> Statement abridged.

which are so often directed to them, must be numberless, though I have not found many of them in the books of entries. Bro. Corporations, pl. 48. A corporation can not be aiding to a trespass, nor give a warrant to do a *trespass without writing*, and cites 4 Hen. 7, 9; and certainly it appears by that case, and by the sequel of it in 4 Hen. 7, 16, that a corporation can not give a command to enter into land, without a deed, nor do a thing which vests or divests a freehold, nor *accept a disseizin made to their use, without deed*. But many little things, it is said, require no command, by which must be meant no special commanding, as a command to servants to chase cattle out of their lands, or to make hay; being things which it is incident to a servant to do, and which he is bound to do without command: and if he do it, it is good, and the command is not material, for he may do it without command.

A corporation can not do *a tort but by their writing under their common seal*: per Fitzjames, Justice; Bro. Corporations, pl. 34, cites 14 Hen. 8, 2, 29, which imports that *by their writing* they may. A corporation may be defendants in an action of *quaere impedit*, and the hindrance is an act of *tort*. Butler v. The Bishop of Hereford and the University of Cambridge, Barnes C. P., 350; to which a multitude of other instances may be added: Rast., 497; Ast., 378; 2 Mod. Enc., 291; Winch. 625, 700, 721, 733; 2 Lut. 1100; 3 Lev. 332. The statute, 9 H. 4, c. 5, recites the practice, in assizes of novel “disseizin in other pleas of land, of naming the mayor and bailiffs and commonalty of a franchise, as disseizors, in order to oust them of holding plea thereof; and directs the inquiry before the judges of assize, whether they be disseizors or tenants, or be named by fraud;” which plainly proves that they may be considered as disseizors; and there are instances of trespass against corporations. In 44 Ed. 3, 2, pl. 5, which was after 22 Ass., pl. 67, cited in the argument. Trespass was brought against the mayor and commonalty of Hull and another person; and the objection made was not that trespass would not lie against the corporation, but that as a natural person was joined with them, there must be different processes; a distress against the former and a *capias* against the latter: But the objection does not appear to have prevailed.

In 8 H. 6, 1, 14, trespass was brought against the mayor, bailiff and commonalty, and one of the commonalty; and the objection was not that trespass would not lie against the corporation, but that it could not be supported against them and an individual of their body, and Bro. Corporations, pl. 24, says the better opinion was that the writ was good, and 14 Hen. 8, 2, says it was so awarded, and that in that case all the justices agreed to it. Brook also puts the case, “if mayor and commonalty disseize me, and I release to twenty or 200 of the commonalty; this will not serve the mayor and commonalty;” and the reason is because the disseizen is in their *corporate* character, and the release is to the individuals. And the case is put “that if mayor and commonalty disseize one of their own body, he shall have assize against them,” which clearly imports that the corporation, as

such, might be disseizors. Also, in 4 Hen. 7, 13, trespass was brought against the mayor and commonalty of York; they justified under a right in the inhabitants to have common: but this was adjudged no plea, because the right in natural persons gave no right to the corporation, and the trespass was alleged in the corporation. They then pleaded as bailiff's in aydant: but it was adjudged they could not be bailiffs aiding to a trespass, "nor could they give warrant *without writing* to commit a trespass;" which implies that by proper writing, namely, by deed under their common seal, they might. In the present case, which is after verdict, it must be presumed that a competent conversion was proved, and if it be essential to such conversion that there should have been an authority from the company under seal to detain the notes on their behalf, that such authority was proved. The fact, by reference to my notes, is that it was admitted that the bank detained the notes in question under an indemnity, and as no objection was taken to the terms of the admission, a competent detention, *i. e.*, through the means of servants properly authorized to detain on their behalf, was thereby admitted; and, therefore, the presumption of due proof, after verdict, is in effect warranted by the facts of the case, if it had been material, which it by no means is, to resort to them.

In the case of *The King v. John Bigg*, 3 P. Will. 419, it was made a question upon a special verdict in a case of capital felony, for erasing an indorsement upon a bank note, whether a person intrusted and employed by the governor and company of the Bank of England to sign notes on their behalf, was competently authorized for that purpose, not having been, as the special verdict expressly found, so intrusted and employed *under their common seal*. There is a long and learned argument of the reporter, Mr. Peere Williams, in which the authorities as to what acts a corporation may do by their servant without an authority under their common seal, are drawn together. The majority of the judges who sustained the conviction, must have been of opinion that an authority under their common seal was not essentially necessary for such a purpose; indeed, according to the report in 1 Stra. 18, of the same case, the doubt of the judges must have turned upon another point, namely, upon the import of the word *indorsement* (*i. e.*, the writing alleged to be erased); and whether it could be satisfied by an erasure of what was written on the face of the note. As to which Sir John Strange in his report says: "That it was held by all the judges that the defendant was guilty; for the writing on the face of the note was of the same effect as an indorsement, and being introduced by the company instead of writing on the back, and always accepted and taken to be an indorsement, was within the words of the indictment." The objection of the want of authority under the common seal is not even noticed in the report of this case by Sir John Strange. However, if there would have been anything in the objection in this case, if made at the trial, there is nothing in it after verdict, when it must be presumed, as I have already stated, that all the competent proof which could be made in support of the action was made, and of course that an authority under

seal for the detention of the notes was proved, if such proof were at all necessary.

Rule discharged.

*Note. Liability for torts in general.*

1. *As to the old doctrine.* see note to *Eastern Counties R. Co. v. Broom*, 6 Exch. 314, *infra*, p. 1246, and note, *supra*, pp. 75-6.

2. *Modern doctrine*—Corporations are liable for torts, substantially as a master is liable for the torts of his servants, while engaged in the master's business, and in this connection the managers of the corporation are practically the corporation, the whole of the corporate duties being vested in them: 1827, *Lyman v. White River Bridge Co.*, 2 Aikens (Vt.) 255, 16 Am. Dec. 705; 1840, *Rhodes v. City of Cleveland*, 10 Ohio 159, 36 Am. Dec. 82; 1848, *Meares v. Commissioners*, 9 Ired. Law (N. C.) 73, 49 Am. Dec. 412; 1849, *Vanderbilt v. R. T. Co.*, 2 N. Y. 479, 51 Am. Dec. 315; 1852, *Lesh v. Wabash Nav. Co.*, 14 Ill. 85, 56 Am. Dec. 494; 1853, *Goodspeed v. East Haddam Bank*, 22 Conn. 530, 58 Am. Dec. 439, *infra*, p. 1256; 1855, *Jones v. West Vt. R. Co.*, 27 Vt. 399, 65 Am. Dec. 206; 1856, *Henderson v. San Antonio, etc., Co.*, 17 Texas 560, 67 Am. Dec. 675; 1857, *Hopkins v. A. & St. L. Co.*, 36 N. H. 9, 72 Am. Dec. 287; 1858, *Phil., W. & B. R. Co. v. Quigley*, 21 How. (162 U. S.) 202; 1867, *Maynard v. Fireman's F. I. Co.*, 34 Cal. 48, 91 Am. Dec. 672; 1877, *Peebles v. Patapsco Guano Co.*, 77 N. C. 233, 24 Am. Rep. 447; 1884, *Child v. Boston, etc., Iron Works*, 137 Mass. 516, 50 Am. Rep. 328; 1887, *Wheeler & Wilson Mfg. Co. v. Boyce*, 36 Kan. 350, 59 Am. Rep. 571, *infra*, p. 1250; 1888, *Miller v. Coal Co.*, 31 W. Va. 836, 13 Am. St. Rep. 903; 1891, *Columbus, etc., Coal Co. v. Tucker*, 48 Ohio St. 41, 29 Am. St. Rep. 528; 1893, *Nims v. Mt. Hermon School*, 160 Mass. 177, 39 Am. St. Rep. 476, *infra*, p. 1268; 1894, *Dorsey Machine Co. v. McCaffrey*, 139 Ind. 545, 47 Am. St. Rep. 290; 1895, *Pittsburgh, C., C. & St. L. R. v. Sullivan*, 141 Ind. 83, 50 Am. St. Rep. 313.

See, also, notes to cases following.

## Sec. 389. (2) *Nuisance*, obstructing stream.

### THE CHESTNUT HILL & S. H. TURNPIKE CO. v. RUTTER.<sup>1</sup>

1818. IN THE SUPREME COURT OF PENNSYLVANIA. 4 Serg. & R. (Pa.) Rep. \*6-18, 8 Am. Dec. 675.

TILGHMAN, C. J. This is an action on the case, brought by James Rutter against The Chestnut Hill & Spring House Turnpike Company, for an injury done to the plaintiff's land and tanyard, in consequence of certain piers erected by the defendants, on each side of a stream of water, by which the stream was obstructed and thrown back, and overflowed the plaintiff's land.

The defendants below, who are plaintiffs in error, rely on two ob-

<sup>1</sup> Arguments, except a small part of Judge Ingersoll's, omitted.

jections: 1. That a corporation is not suable in this kind of action<sup>1</sup>; 2. That the declaration does not state a good cause of action, even if the defendants were liable to an action in this form.

1. Corporations have lately been so multiplied in the United States that they stand a very prominent part in the business of the country. It has, therefore, been necessary to consider with great attention their nature and their rights, both as to suing and being sued. And as it would be extremely inconvenient that they should do wrong without being amenable to justice, the inclination of the court has been to hold them responsible. There was a time when it seems to have been supposed that they could make no contract but by writing under their common seal. The reason assigned was, that being incorporeal, and consequently incapable of speaking, it was impossible that they should enter into a parol contract. But, upon reflection, this reason has been thought insufficient, for if pursued to its full extent it would prove that a corporation could not act at all. It has no hand to affix a seal, and must therefore employ an agent for the purpose. But this agent must receive his authority previous to affixing the seal. It is necessary, therefore, that the corporation should have the power to act without seal, so far as respects the appointment of a person to affix the seal. Now if it can appoint an agent without seal for one purpose, there is no reason why it may not for another. Accordingly, in the case of *The King v. Bigg*, 3 P. Wms. 419, on a special verdict in a case of capital felony, it was held that the Bank of England might, *without seal*, authorize a person to sign notes in its behalf. And it was decided by the supreme court of the United States, in the case of *The Bank of Columbia v. Patterson's Administrators*, 7 Cranch 299, that a corporation may, *without seal*, enter into a contract, express, or even implied. In the words of Judge Story, by whom the opinion of the court was delivered, "when a corporation is acting within the scope of the legitimate purpose of its institution, all parol contracts made by its authorized agents, are

<sup>1</sup> *Ingersoll*, for plaintiff in error, argued: Corporations are the creatures of the law, of a highly refined and intangible nature, whose properties and attributes lawyers alone can understand. Deriving their existence from the law, they must be governed by the terms of the law which creates them. They must proceed and be pursued in the path prescribed by the law. If the corporators do an act beyond their corporate powers, they, as individuals, and not the corporation of which they are members, must answer it. If the corporation itself enter into a contract not authorized by its charter, no action founded on the contract can be sustained, though the individual members may be sued. Suppose an insurance company should undertake to make a turnpike road, or to build a church, could those who were employed by them recover against the corporation as such? Every principle of the law of corporations forbids it. Now, a corporation never was and never can be authorized by law to commit a tort; they can invest no one with power for that purpose. If, therefore, an agent constituted for a legal purpose inflict an injury, the corporation is no more answerable than it would be for an act of that agent, done without any authority whatever derived from it, because being unauthorized to commit a wrong, it is out of the scope of its corporate powers. The act of the law, like the act of God, can work a wrong to no one, and if a man sustain damage by it, it is *damnum absque injuria*.

*express* promises of the corporation, and all duties imposed on them by law, and all benefits conferred at their request, raise *implied* promises, for which an action lies." By this decision I consider the law as settled. It does, indeed, seem to have been the opinion of *this court*, in the case of *Breckbill v. The Lancaster Turnpike Company*, 3 Dall. 496, that an action of *assumpsit* would not lie against a corporation. But the law had not been at that time fully considered, and I may say that our late brother Yeates, who was on the bench when *Breckbill v. The Lancaster Turnpike Company* was decided, was satisfied as to the propriety of acquiescing in the authority of *The Bank of Columbia v. Patterson's Administrators*.

But it is objected that the present action is not on *contract* but on *tort*, and a very refined argument is brought forward to prove that a corporation can not be guilty of a tort. A corporation, say the defendant's counsel, is a mere creature of law, and can act only as authorized by its charter. But the charter does not authorize it to do wrong, and, therefore, it can do no wrong. The argument is fallacious in its principles and mischievous in its consequences, as it tends to introduce actual wrongs and ideal remedies; for a turnpike company may do great injury by means of laborers who have no property to answer the damages recovered against them. It is much more reasonable to say that when a corporation is authorized by law to make a road, if any injury is done in the course of making that road by the persons employed under its authority, it shall be responsible in the same manner that an individual is responsible for the actions of his servants touching his business. The act of the agent is the act of the principal. There is no solid ground for a distinction between contracts and torts. Indeed, with respect to torts, the opinion of the courts seems to have been more uniform than with respect to contracts. For it may be shown that from the earliest times to the present corporations have been held liable for torts. Many cases have been cited from the year books. Upon examination they do not all answer the citations, but enough appears to show that the law was so understood. In 4 Hen. 7, p. 13, pl. 11, we find an action of trespass against the mayor and commonalty of York. Plea, that all the inhabitants had a right of common in the land where the trespass is supposed to have been committed; *held*, not good, because the action is against the *corporation*, and the plea is a justification as to *individuals*. In a subsequent part of this case it is said that a corporation can not give a warrant to commit a trespass *without writing*. This, if it be law, proves that a warrant may be given by writing, which is sufficient for the plaintiff's purpose, the point being whether a corporation can commit a trespass. In 8 Hen. 6, p. 1, pl. 11, and p. 14, pl. 34, trespass was brought against the mayor and bailiffs and commonalty of Ipswich, and one J. Jabez. It was objected that a corporation and an individual can not be joined in one action, but it was not objected that trespass does not lie against a corporation, and the objection is said to have been overruled in 14 Hen. 8, 2.

In the book of assizes (31 Ass. pl. 19), it appears that an assize



of novel disseizin was maintained against the mayor and commonalty of Winton. Brook lays it down that if the mayor and commonalty disseize one who releases to several *individuals* of the corporation, this will not serve the mayor and commonalty, because the disseizin is in their *corporate* capacity. In the old books of entries are numerous precedents of writs of *quaere impedit* against corporations, and in Vidian's Ent. 1, is a declaration in an action on the case, (16 Car. 2) against the mayor and commonalty of the city of Canterbury, for a false return to a *mandamus*. To come to more modern times, it was held in the Mayor of Lynn, etc., (in error) v. Turner (Cowp. 86) that an action on the case lies against a corporation for not cleansing and keeping in repair a stream of navigable water, which it was bound to do by prescription, in consequence of which the plaintiff was injured. This was in the year 1774, a little before our revolution. The laws of the commonwealth forbid my tracing this point through the English courts since the revolution, but we shall find abundant authority in the courts of our own country. In Gray v. The Portland Bank, 6 Mass. Rep. 364, it is laid down that the bank was responsible for wrongs done by itself or its agents. In Riddle v. The Proprietors of the Locks, etc., on Merrimack River, 7 Mass. Rep. 169, an action was maintained against the company for damage suffered by the plaintiff in consequence of the locks not being kept in repair. And in Townsend v. The Susquehannah Turnpike Company, 6 Johns. 91, an action was supported for the loss of a horse, killed by the falling of a bridge, which the company had built of bad materials. These authorities put it beyond doubt that the form of action in the present case is good.

The objection to the declaration remains to be considered. It is said that the act of assembly by which this company is chartered gives them power to erect bridges over all the streams which cross the road, and, therefore, they are not responsible for any damages which may be suffered in consequence of these bridges. But this is too broad a proposition: for, granting that they would not be responsible for damages unavoidably resulting from a bridge built in the best manner, and obstructing the passage of the water no more than was necessary for its proper construction, it would not follow that they should not be answerable for damages arising from a bridge so carelessly or inartificially built as to occasion an unnecessary and wanton obstruction. Now, the declaration alleges that the defendants, contriving and wrongfully and injuriously intending to injure the plaintiff, etc., *did wrongfully and unjustly set up certain piers, etc.* So that we are bound, after verdict, to suppose that it was proved the defendants were in fault in the manner of erecting the piers. To say now that they were guilty of no wrong would be to declare that it is impossible for them to be made answerable for *any injury which may arise from any kind of bridge or piers*. This is going farther than I can permit myself to do, being satisfied that the law never intended to authorize damage without necessity. Whether the company would be answerable for damages occasioned by a bridge or piers of proper

construction is a point of great importance, on which I give no opinion, as it does not arise in this case. I am of opinion, on the whole, that the judgment should be affirmed.

Judgment affirmed.

*Note.* Compare *Riddle v. Proprietors, etc.*, 7 Mass. 169, *supra*, p. 47.

### Sec. 390. (3) Trespass to property.

#### MAUND v. THE MONMOUTHSHIRE CANAL CO.

1842. IN THE COURT OF COMMON PLEAS. 4 Manning & Granger  
(43 Engl. C. L.) \*452.

Trespass for breaking and entering locks on a canal, and seizing and carrying away barges and coal.

Pleas, not guilty (by statute), 36 G. 3, c. cii, and payment of money into court.

At the trial, before Creswell, J., at the last assizes for Monmouthshire, it was proved that the trespass in question had been committed by one Cooke, who was the agent of the company, which was incorporated by act of parliament, 36 G. 3, c. cii, and that the barges and coal had been seized for tolls claimed to be due to them. The only question raised was whether trespass would lie against a corporation aggregate for an act done by their agent within the scope of his authority. A verdict was taken for the plaintiff, damages £50, leave being reserved to move to enter a verdict for the defendants.

*Talfourd*, Serjt., in last term, obtained a rule *nisi* accordingly, or to arrest the judgment. He cited the case of *Sutton's Hospital*, 10 Co. Rep. 32, Anon, 12 Mod. 559; *Morgan v. The Corporators of Carmarthen*, 3 Keb. 350; *Thusfeld and Jones' Cases*, Skin. 27; Com. Dig. tit. Franchises (F. 19), 6 Vin. Abr., tit. Corporations (B. a.).

*Ludlow*, Serjt., now showed cause. The act of parliament by which the company is incorporated provides that they may sue and be sued; it also empowers them to enter on lands. If they enter improperly it would seem that they may be sued for the trespass. The whole doctrine that a corporation can not be sued in trespass rests on one passage in Bro. Abr. Corporations, 43;<sup>1</sup> where the reason given is that neither *capias* nor *exigent* can go against them. A *distringas*, however, may be issued against a corporation. It has been

<sup>1</sup> "Nota, per Thorpe, that trespass lies not against commonalties, to wit, by the name of corporation, but against the person who did it, by their proper names; for neither *capias* nor *exigent* lies against a commonalty; nor shall a commonalty implead or be impleaded but with the mayor or bailiffs, if they have mayor or bailiffs; and there by him (*i. e.* according to Thorpe) there may be a corporation by name of a commonalty, without mayor, bailiff or other head." Citing 22 Ass., p. 67 (22 Ass., fo. 100, pl. 67.)

decided that trover will lie against a corporation: *Yarborough v. The Bank of England*, 16 East 6, where Lord Ellenborough, C. J., in giving the judgment of the court, reviews all the authorities upon the subject. (Tindal, C. J. That case was after verdict. It was a motion in arrest of judgment; no leave appears to have been reserved.) But the broad doctrine is laid down that trover would lie; and there is no difference in principle between that action and trespass. The payment into court in this case admits that the action is rightly brought. An indictment will lie against a corporation, although all the ordinary consequences can not follow. Various instances are collected in *Kyd on Corporations*, vol. i, pp. 223-225, where trespass has been brought against a corporation. Other authorities are mentioned in 1 *Wms. Saund.*, 340, n. The principle that a corporation is liable in tort for the tortious act of its agent, done in its ordinary service, is further carried out in *Smith v. The Birmingham Gas Company*, 1 A. & E. 526. (Tindal, C. J. The process is the same, both in case and in trespass—namely, by attachment, distress, capias and outlawry. If case will lie, it is difficult to see why trespass should not lie also.)

*Talfourd, Serjt.*, was then called upon to support the rule, and admitted that he had nothing to rely upon but the old authorities, and that in *Regina v. The Birmingham and Gloucester Railway Company*, 2 Q. B. Rep. 47, the court of queen's bench had, in this term, refused to quash an indictment against a corporation. The doctrine in *Bro. Abr.*, however, is imported into *Com. Dig.*, tit. Franchises (F. 19.).

TINDAL, C. J. The process in case and trespass being the same, it is impossible to see any distinction between the two actions.

*Per curiam*,

Rule discharged.

*Note.* See, also, 1839, *Whiteman's Ex. v. Wilmington, etc., R. Co.*, 2 Harr. (Del.), 514, 33 Am. Dec. 411; 1848, *Hay v. Cohoes Co.*, 3 Barb. (N. Y.) 42; 1896, *Sunnyside, etc., Coke Co. v. Reitz*, 14 Ind. App. 478, 43 N. E. Rep. 46.

## Sec. 391. (4) Assault and battery.

### EASTERN COUNTIES RAILWAY CO. AND RICHARDSON v. BROOM.<sup>1</sup>

1851. IN THE EXCHEQUER CHAMBER. 6 Exchequer (Welsby, H. & G.) Reports 314-326, 2 Eng. L. & Eq. 406.

[Broom, a passenger on the railway, brought an action of trespass for assault, battery and false imprisonment, against the company, and Richardson, its inspector. The plaintiff's evidence showed that he

<sup>1</sup> Statement abridged. Most of arguments omitted. Only part of opinion given.

was a passenger in defendant's car, that he was assaulted in the car, forcibly taken out of the same, and imprisoned by Richardson, then an inspector in the service of the company, professing to act in so doing as its servant, and under assertions of justification which the evidence failed to establish. The court, in leaving the evidence to the jury, said the company could be liable in one of two ways: "If, beforehand, they gave instructions to their servants to remove from their cars any who disobeyed the by-laws, and commit him to a policeman, if they gave their directions generally, there was no doubt they would be liable. They would also, if, discovering that their servant, acting on their behalf, had given the plaintiff into custody, they adopted the act, and directed their attorney to follow that up and prosecute the charge." This was objected to, and it was contended that an action of trespass for assault and battery does not lie against a corporation aggregate; that in order to render the corporation liable for such an act by an agent, the authority to do the act must be given by an instrument under seal; and that such authority must precede the act, since the corporation can not be rendered liable by ratification.]

PATTESON, J. I have conferred with my learned brothers upon this case, and we are all of opinion that there is no reason why we should defer our judgment. The first question arises on the declaration itself, and is quite independent of the particular circumstances of this case. It is alleged on the part of the plaintiffs in error, as a general broad proposition of law, that in no case can an action of trespass for assault and battery lie against a corporation aggregate. Whatever may be the effect of the authorities in the Year Books, it has been expressly held, in modern times, that trespass will lie against a corporation aggregate for breaking and entering a close, and for seizing goods. This has been decided by several recent cases. Then the question is whether trespass for assault and battery may lie against a corporation, and it has been contended that it can not, for it is said that it can neither beat nor be beaten. No doubt that proposition is true of it as respects its corporate capacity. But it does not, therefore, follow that if a corporation, by authority under seal, direct a servant to apprehend and imprison a particular person, an action for assault and battery can not be maintained against the corporation. The learned counsel who appears for the plaintiffs in error must contend, in order to show that this declaration can not be supported, that no such action would lie. But we are all clearly of opinion that it is not so, and that an action of trespass for assault and battery will lie against a corporation whenever the corporation can authorize the act done, and it is done by their authority. We are, therefore, of opinion that the declaration is good: and we do not think it necessary to go through the several authorities upon this question. The next question is whether, in order to render the corporation liable for the act of their servant, it was necessary that that servant should have an authority by deed. It has been decided, many years ago, that a corporation may be liable in tort for the acts of their servants, although their authority be not

under seal. It is not necessary, therefore, further to advert to this point.

With respect to the point, whether the company could ratify the act, if the act can be said to have been done for the use or benefit of the company, there can be no doubt that they could ratify it. The assault and imprisonment of a party liable to the company for not having paid his fare was an act of the servant of the company, which manifestly might have been for the benefit of the company. Therefore, we are clearly of opinion that there might have been a ratification of that act. The law is well laid down in distinct terms in the passage from the 4 Inst. 317, "He that receiveth a trespasser, and agreeth to a trespass after it be done, is no trespasser, unless the trespass was done to his use or for his benefit, and then his agreement subsequent amounteth to a commandment." The question of liability by ratification depends upon this, whether the act was originally intended to be done to the use or for the benefit of the party who is afterwards said to have ratified it. We are with the plaintiff in this case, that the action might lie, and the act, though not done with the knowledge of the company in the first instance, might have been ratified by them; but we are of opinion that there was no evidence of any such ratification, and that the direction of the lord chief baron was wrong in this respect. The result, therefore, is that there must be a *venire de novo*.

*Venire de novo.*

*Accord:* 1846, *Edwards v. Bank*, 1 Branch (Fla.) 136; 1851, *Railroad Co. v. Dalby*, 19 Ill. 352; 1867, *Brokaw v. R. Co.*, 32 N. J. L. 328, 90 Am. Dec. 659, *infra*, p. 1249; 1869, *Goddard v. Railway Co.*, 57 Maine 202, 2 Am. Rep. 39; 1876, *Rounds v. L. & W. R. Co.*, 64 N. Y. 129; 1882, *C. & E. R. Co. v. Flexman*, 103 Ill. 546, 42 Am. Rep. 33; 1887, *Denver & R. G. R. Co. v. Harris*, 122 U. S. 597; 1898, *Johnson v. Pioneer Fuel Co.*, 72 Minn. 405, 8 Am. & E. C. C. (N. S.) 708, note 712; 1898, *Trabing v. Cal. Nav. & Imp. Co.*, 121 Cal. 137, 8 Am. & E. C. C. (N. S.) 695, note 704; 1899, *Southern Ex. Co. v. Platten*, 36 C. C. A. 46, 93 Fed. Rep. 936, 10 A. & E. C. C. (N. S.) 521; 1899, *Maisenbacker v. Society Concordia*, 71 Conn. 369, 71 Am. St. Rep. 213, *infra*, p. 1279.

*Note. The old doctrine:* Most of the old (and now obsolete) learning on the liability of corporations for torts is found well summarized by Burnet, J., in *Orr v. Bank of U. S.*, 1 Ohio 36 (1822), as follows:

This is an action for an assault and battery, and false imprisonment. The declaration is filed in the common form, charging the defendants jointly with the commission of the trespass, as though they were all natural persons. The defendants have demurred generally. On the argument two principal questions were raised and discussed.

1. Whether a corporation aggregate is liable to be sued by its corporate name, in an action of trespass for an assault and battery, and false imprisonment.

2. Whether, if they be not so liable, the defendants, Creighton and Dunn, can take advantage of the joinder on this demurrer.

On the first question, Chitty has been cited (1 vol., 66), where he says, corporations may be sued in that character, in many instances, for damages arising from neglect of duty, imposed on them by particular statutes, but they can not in general be sued in that character in trespass or replevin. The action must be brought against each person by name, who commits the tort.

In 8 East. 230, Lawrence, Justice, says, trespass does not lie against a cor-



poration. Thorp, Justice, says, trespass does not lie against a corporation aggregate by its corporate name, for a *capias* and *exigent* do not lie against it. 22 Ass. 67. A corporation can not beat nor be beaten, nor commit treason, nor felony, nor be outlawed, etc. 21 Edw. 4, 7, 12, 27, 67. They can not be essoigned. 1 Bac. Ab. 507. Nor outlawed. 10 Co. 32. Nor attached. Ray, 152. No *replevin* lies against them by the name of their corporations. Brownl. 175. They can not be declared against in custody. 6 Mod. 183. They are not indictable, though the particular members are. 12 Mod. 559. They can not sue as a common informer. 2 Stra. 1241. For torts they must be sued individually. Salk. 192. Trespass does not lie against a corporation, but against its members. 4 Com. Franchise F. 19.

A corporation can not commit a trespass but by their writing under their seal. Vin. Ab. Cap. K. 22. Trespass does not lie against commonalty, but shall be against the persons, by their proper names, for *capias* and *exigent* lie not against commonalty. Vin. Ab. Cap. P. 2. Trespass does not lie against a corporation, viz: by the name of corporation, but against the persons who did it, by their proper names, for *capias* and *exigent* do not lie. Vin. Ab. Cap. 2, 15. As outlawry does not lie against an aggregate corporation, therefore trespass does not lie against them, for a *capias* and *exigent* do not go. 2 Sell. 149; 2 Imp. 675; Bro. Corp. 43. A corporation can neither maintain nor be made defendant to an action of battery, or such like personal injuries, for a corporation can neither beat nor be beaten in its body politic. 1 Blac. Com. 503. It appears also that the civil law ordains (in conformity with this rule) that for the misbehavior of a body corporate, the directors only shall be answerable in their personal capacities. Wooddeson, in his *Lecture on Corporations* (1 vol., 494), is very clear and explicit on the subject. He says: "It is incident to all bodies politic to sue and be sued by their name of incorporation, but it is manifest that this must be restricted to particular actions; thus, corporations can neither be plaintiffs nor defendants in actions of assault and battery."

The case in 12 Johns. 227, cited by the plaintiff, shows that the law in relation to the liability of corporations is so changed by the course of modern decisions, that they are now held responsible on promises, express or implied, and that *assumpsit* may be maintained against them on such promises. But because the law has been changed in relation to contracts, it does not follow that it is also changed in relation to torts, so as to render a corporation liable, generally, to actions of trespass, or for other torts, by persons not belonging to the body corporate, at least without showing that they were done by an authority from them, granted in pursuance of their charter. In short, the only question decided in that case was that a corporation may make a valid contract, not under seal; and this point being settled, there was no incongruity or falsity apparent in the declaration, and, therefore, the court very properly decided that they would not stop and inquire, in that stage of the proceedings, whether the contract was made in such manner or by such persons as to be binding on the defendants. The objection in that case was taken on the broad ground that *assumpsits* will not lie under any circumstances against a corporation, but the court, having shown very clearly that the position was not tenable, overruled the demurrer without further inquiry, and it may be remarked that the reasoning of the court is confined exclusively to matters of contract. The same observation may be made respecting the case of the *Bank of Columbia v. Patterson* (cited from 7 Cran. 299), which was an action of *assumpsit* for work and labor. Various questions arose in the progress of that cause, none of them, however, having a direct bearing on the case now before the court. The point most analogous was that whenever a corporation is acting within the scope of the legitimate purposes of its institution, all parol contracts made by its authorized agents are express promises of the corporation, and all duties imposed on them by law and all benefits conferred at their request raise implied promises for the enforcement of which an action may well lie.

The case of *Dunn v. The Rector, etc., of St. Andrews' Church* (14 Johns. 118), was also *assumpsit* for work and labor. The only question agitated was,



whether an action of assumpsit on an implied promise can be maintained against a corporation, which was decided affirmatively, on the authority of the two cases just considered.

Much reliance has been placed by the plaintiff on the case of *Riddle v. The Proprietors of the Locks and Canals on Merrimack River*, 7 Mass. Rep. 169. This was an action on the case, for not sufficiently opening and keeping in repair a certain canal, by reason of which the raft of the plaintiff grounded in attempting to pass it, and was damaged. A verdict was rendered for the plaintiff, and a motion for a new trial having been overruled, a motion was made in arrest of judgment, on the ground that at common law no action lies against a corporation for a tort, because, among other reasons, judgment in such an action is entered with a *capiatur*, which would be absurd against a corporation. The court, in giving their opinion on this point, seem to admit the doctrine in 21 Edw. 4, 12, 27, 67, that a corporation can not be beaten, nor beat, nor commit treason, nor felony, nor be imprisoned for a disseizin with force, nor be outlawed, and they add that these principles result from the nature of an aggregate corporation. But in remarking on the opinion of Thorp, Justice, in 22 Ass., pl. 67, in which he says that trespass does not lie against a corporation aggregate by its corporate name, they express doubts. Thorp's opinion, they say, has been overruled as to certain trespasses, and referring to some of the authorities in 16 East., from which they say it is very clear that some actions of trespass might at common law be maintained against aggregate corporations, they conclude that as in these cases no *capiatur* could be entered, the omission of this entry could be no objection to actions on the case. This concise statement is sufficient to show that the question now in hand did not necessarily arise. The point determined was, that trespass on the case would lie, and that judgment in such an action might be entered without a *capiatur*, and for this purpose only, the authorities relating to trespass and other torts were referred to. But it can not escape the most careless observer that neither the case decided, nor those referred to, support the position now contended for, that assault and battery can be sustained against a corporation aggregate. Thorp's opinion was questioned only as to certain trespasses, and the court went no farther than to say that some actions of trespass might be maintained, from which the conclusion naturally follows that, generally, that action can not be maintained, and they admit that a corporation aggregate, from its nature, can neither beat nor be beaten, which seems to be decisive of the questions we are considering. It was urged by the plaintiff that the reason on which the law, under consideration, was originally founded, had ceased to exist, and that therefore the law itself has ceased, in conformity with the maxim *Cessat raito, cessat etiam lex*. But however true this maxim may be in the general, it is subject to exceptions. There are many principles of common law settled on reasons that have ceased, and many more on reasons that have not only ceased, but are now forgotten, that are still in full force; as, for example, it is law at the present day that debt and trespass can not be joined, although the reason of this law no longer exists, which was, that in debt the process was summons, on which a fine was paid to the king, in proportion to the sum demanded, but in trespass the process was a *capias*, and the court set a fine in proportion to the offense.

It is not, however, admitted that all the reasons, or that the most weighty reasons of the law in question, have ceased, for although the distinction of process is done away by our statute, yet it remains a truth that a corporation aggregate, as such, can not commit the act charged in this declaration, as they have no personal existence, and can neither beat nor be beaten. An action for an assault and battery, committed on a corporation aggregate in their corporate character, would be a novelty in judicial proceedings; and yet it appears to be as contrary to reason and common sense that they should be the agents in such a trespass as it is that they should be the objects of it. It is a fact entitled to some weight that among the multitude of adjudged cases relating to corporations, from the year books to the present day, not one can be found that decides the principle as it is contended for by the plaintiff. Al-

though it forms no objection to an action that such an one has never before been brought, yet the fact affords strong presumptive evidence that the law is against it.

On the whole, whatever exceptions may exist to the rule that actions of trespass generally do not lie against corporations, it is evident that the action now under consideration can not be one of those exceptions, and, therefore, that it can not be sustained against the bank. (Opinion on other point omitted.)

*Compare*, also, *Childs v. Bank of Mo.*, 17 Mo. 213 (1852), where the same reasoning is applied to *false imprisonment*, *slander* and *libel*; also *P. W. & B. R. v. Quigley*, 21 How. (U. S.) 202 (1858), Justice Daniel dissenting in regard to libel.

### Sec. 392. Same. Joinder of corporation and servant as defendants.

#### BROKAW v. NEW JERSEY R. R. AND TRANSP. CO.<sup>1</sup>

1867. IN THE SUPREME COURT OF NEW JERSEY. 32 N. J. Law (3 Vroom) 328, 90 Am. Dec. 659.

DEPUE, J. The declaration in this case charges that the New Jersey Railroad and Transportation Company, by their servants, and William Campbell, the other defendant, with force and arms assaulted the plaintiff, and ejected and expelled him from a certain car in which he was riding on the New Jersey railroad, and wounded, bruised and ill treated him.

To this declaration the defendants have filed a general demurrer, and upon the argument two questions were raised: 1. Whether an action of trespass for an assault and battery can be maintained against a corporation; and 2. Whether in such action an individual can be joined as a co-defendant with a corporation. [After holding that an action of trespass for assault and battery will lie against a corporation, proceeds]: \* \* \*

The second ground of demurrer is that William Campbell is joined as a defendant with the New Jersey Railroad and Transportation Company. The joinder is proper; for in trespass all the actors are principals, and may be joined in one suit; and an individual and a corporation may be joined as defendants in the same suit. 1 Vin. Abr., tit. Abatement, Z, p 32; Brown on Corporations, pl. 24.

Both the defendants are charged as principals, and it does not appear that Campbell was the servant of the company, and if it did the joinder would still be proper. A joint action of tort in the nature of trespass may be maintained against a corporation and its servants for a personal injury inflicted by the latter, in discharging the duties imposed on him by the corporation. *Hewett v. Swift*, 3 Allen 420; *Moore v. Fitchburg R. Co.*, 4 Gray 465 (64 Am. Dec. 83).

In considering this case we have not overlooked the case of *Orr v. Bank of the United States*, 1 Ohio 36 (13 Am. Dec. 588), which was

<sup>1</sup> Only that part of the opinion relating to joinder of parties is given.

much relied on by the defendants' counsel. That case proceeds on principles long since obsolete, and is against all the later authorities. The demurrer is overruled.

*Accord:* 1885, *Moore v. Fitchburg R. Corporation*, 4 Gray (Mass.) 465, 64 Am. Dec. 83, note 86; 1887, *Hussey v. Norfolk, etc., R. Co.*, 98 N. C. 34, 2 Am. St. Rep. 312.

### Sec. 393. (5) False imprisonment.

#### THE WHEELER & WILSON MANUFACTURING CO. v. JACOB F. BOYCE.<sup>1</sup>

1887. IN THE SUPREME COURT OF KANSAS. 36 Kan. Reports 350-357, 59 Am. Rep. 571.

Action by *Boyce* against *The Wheeler & Wilson Manufacturing Company* and two others to recover damages for false imprisonment. Trial at the April term, 1884, and judgment for plaintiff for \$1,000, with interest and costs. The defendant *Company* and its agent *Baker* bring the case to this court. The opinion states the facts.

JOHNSTON, J. This is a proceeding to reverse a judgment rendered in an action for false imprisonment, brought by Jacob F. Boyce against the Wheeler & Wilson Manufacturing Company, C. S. Baker and J. W. Hughes. Hughes was dismissed from the action, and the judgment went only against the plaintiffs in error. The facts upon which the case was disposed of are substantially these: The Wheeler & Wilson Manufacturing Company, a corporation organized for the manufacture and sale of sewing machines, was engaged in business at Topeka, Kan., and C. S. Baker was its general agent at that place. The company had sold a sewing machine to Mary Hatfield, who subsequently married Jacob F. Boyce, the defendant in error. She paid a part of the purchase-money, and signed a contract in substance that the title to the machine should remain in the company until the balance of the purchase-money was paid. In November, 1881, the company directed its general agent to bring an action of replevin against Mary Boyce to recover the machine, claiming that there was a balance due thereon, a claim which she denied.

An action of replevin was begun before a justice of the peace, and a writ was issued and placed in the hands of Constable Hughes, who reported that he had made search for the machine and was unable to obtain possession of it. C. S. Baker, the agent of the company, then directed Hughes to make and file an affidavit before the justice of the peace, alleging that Mary Boyce, and her husband, Jacob F. Boyce, were in possession of the machine, and had refused to deliver it to

<sup>1</sup> Part of opinion on other points omitted.

him, and thus obtain a warrant for their arrest. This was done, and the justice issued a warrant to the constable commanding him to arrest Boyce and his wife, and commit them to the Shawnee county jail, there to remain until they should deliver the machine. Under this warrant, Jacob F. Boyce was arrested and placed in jail without being taken before the justice, and without any examination, hearing, or trial. The constable informed the general agent of the company that he had arrested Boyce, and placed him in the county jail, as requested, and Baker replied, "Now, I guess, he will give up the machine." The replevin action resulted in a judgment in favor of Mary Boyce. Jacob F. Boyce was held in the county jail for ten days, and was never taken before any court or officer for examination or trial, and was finally discharged at the instance of the plaintiffs in error, and he became sick in consequence of his confinement. He at once instituted this action, and the jury awarded him damages in the sum of one thousand dollars, and the verdict was approved by the trial court. The plaintiffs in error complain chiefly of the rulings of the court in the matter of charging the jury. The jury were instructed that if the evidence justified it, they could find exemplary damages or smart-money against the defendants.

After the jury had been out some time, and had practically agreed upon their verdict, the court recalled them and advised them that he was in error in giving the instruction that they might in their discretion assess exemplary damages, and withdrew it from the jury, telling them that in their deliberations they should not consider the instruction withdrawn. Objection was made to the withdrawal of the instruction, and an application of plaintiffs in error for leave to address the jury after the modification had been made was denied, and this ruling is assigned as error. This decision affords the plaintiffs in error no ground for complaint. The action of the court was favorable rather than prejudicial to their interests. The instruction given was predicated upon sufficient facts, was warranted under the law, and the defendant in error alone had reason to complain of its withdrawal. It is a well-established principle of jurisprudence, that corporations may be held liable for torts involving a wrong intention, such as false imprisonment, and exemplary damages may be recovered against them for the wrongful acts of their servants and agents done in the course of their employment, in all cases and to the same extent that natural persons committing like wrongs would be held liable. In such cases the malice and fraud of the authorized agents are imputable to the corporations for which they acted. This principle is too well settled to require argument, and the authorities sustaining it are numerous and well-nigh unanimous. (*Railroad Co. v. Slusser*, 19 Ohio St. 157; *A. & G. W. Rld. Co. v. Dunn*, 19 Ohio St. 162; *Goddard v. Grand Trunk Rly.*, 57 Maine 202; *Railroad Co. v. Quigley*, 21 How. 213; *Railroad Co. v. Arms*, 91 U. S. 489; *Railroad Co. v. Bailey*, 40 Miss. 395; *Railroad Co. v. Blocher*, 27 Md. 277; *Hopkins v. Railroad Co.*, 36 N. H. 9; *Railroad v. Hammer*, 72 Ill. 353; *Reed v. Home Savings Bank*, 130 Mass. 443;

Fenton v. Sewing Machine Co., 9 Phila. 189; Goodspeed v. East Haddam Bank, 22 Conn. 530; Boogher v. Life Ass'n of America, 75 Mo. 319; Wheless v. Second National Bank, 1 Bax. 469; Jordan v. Railroad Co., 74 Ala. 85; Williams v. Insurance Co., 57 Miss. 759; Vance v. Railway Co., 32 N. J. L. 334; Cooley on Torts, 119; 3 Sutherland on Damages, 270, and cases cited; 2 Wait's Actions and Defenses, 447, and cases cited.

The same doctrine has been fully recognized on several occasions by this court. (L. L. & G. Rld. Co. v. Rice, 10 Kan. 437; M. K. & T. Rld. Co. v. Weaver, 16 Kan. 456; K. P. Rly. Co. v. Kessler, 18 Kan. 523; K. P. Rly. Co. v. Little, 19 Kan. 269; Western News Co. v. Wilmarth, 33 Kan. 510.) The withdrawal of the instruction, although erroneous, was beneficial to the plaintiffs in error, and there can be no reversal unless the erroneous ruling is injurious to the party complaining.

It is next contended that the company can not be held liable for the wrongful acts of Baker and the constable, and an instruction is challenged which holds that if the agent of the company caused and procured the illegal arrest and detention of the defendant in error as charged, the company and its agents were both liable. Baker was the managing agent of the company, his authority was general, and the constable acted wholly under his direction and sanction. He had not only authority to sell machines and collect the money due for the same, but it is conceded that he had authority to institute legal proceedings to recover possession of the machines conditionally sold and for which payment had not been made in accordance with the terms of the sale. The arrest and detention of Boyce was incidental to the replevin action, and was made as alleged to compel the delivery of the machine under a provision of the justices' code relating to replevin, which provides that where the defendants or any other persons knowingly conceal the property replevied, or, having the control thereof, refuse to deliver the same to the officer, they may be committed until they disclose where the property is, or deliver the same to the officer. (Comp. Laws of 1879, ch. 81, § 69.) He had full authority to represent the company, and whatever was done by him was done for the benefit of the company and for the accomplishment of its purpose. His act, although wrongful, was in the line of his employment, was done in the execution of the authority conferred upon him, and must be regarded as the act of the company. To make the corporation responsible it is not necessary, as plaintiffs in error contend, that the principal should have directly authorized the particular wrongful act of the agent, or should have subsequently ratified it. Judge Story, in treating of the liability of principals for the acts of their agents, says that:

"The principal is held liable to third persons in a civil suit for the frauds, deceits, concealments, misrepresentations, torts, negligences and other malfeasances or misfeasances and omissions of duty of his agent in the course of his employment, although the principal *did not*

*authorize or justify or participate in, or indeed know of such misconduct, or even if he forbade or disapproved of them."*

And to sustain this he cites numerous authorities. "In all such cases," he says, "the rule applies, *respondeat superior*, and it is founded upon public policy and convenience, for in no other way could there be any safety to third persons in their dealings either directly with the principal or indirectly with him through the instrumentality of agents." (Story on Agency, § 452.) \* \* \*

*Affirmed.*

*Note.* See, 1861, Owsley v. Railroad Co., 37 Ala. 560; 1882, Frost v. Machine Co., 133 Mass. 565; 1893, Wachsmuth v. Merchants' National Bank, 96 Mich. 426, 21 L. R. A. 278.

## Sec. 394. (6) Libel and slander.

### BEHRE v. NATIONAL CASH REGISTER CO.

1897. IN THE SUPREME COURT OF GEORGIA.' 100 Georgia Rep. 213-216, 62 Am. St. Rep. 320, 27 S. E. Rep. 986.

#### Action of libel.

COBB, JUSTICE. Charles H. Behre brought his action against the National Cash Register Company, a corporation, alleging in his petition that he had sustained damage on account of certain slanderous words which had been uttered by the agent of the defendant while acting in and about the business of said corporation; and also by a libelous writing which the corporation had caused to be published in certain newspapers. On demurrer the court dismissed the declaration, holding that the same set forth no cause of action. To this ruling the plaintiff excepted.

1. The petition alleged that the defendant's agent went about from place to place, and while in the conduct of the defendant's business uttered words in reference to plaintiff which were false and malicious. While it is distinctly alleged that the words complained of were uttered by the agent of defendant within the scope of the agency and in behalf of and for the interest of the defendant, it failed to allege that the defendant expressly directed or authorized the agent to speak the words in question. "A corporation will not be liable for any slander uttered by an officer, even though he be acting honestly for the benefit of the company and within the scope of his duties, unless it can be proved that the corporation expressly ordered and directed that officer to say those very words, for a slander is the voluntary and tortious act of the speaker." Odgers on Libel and Slander, 1st Am. ed. \*368; Newell on Defamation, Slander and Libel, 1st ed., 361.



"As a corporation can act only by or through its agents, and as there can be no agency to slander, it follows that a corporation can not be guilty of slander; it has not the capacity for committing that wrong. If an officer or an agent be guilty of slander he is personally liable, and no liability results to the corporation." Townsend on Slander and Libel, 2d ed., § 265. Dodge v. Bradstreet Co., 59 How. Prac. 164.

2. "A corporation may make a libelous publication." Howe Machine Company v. Souder, 58 Ga. 65. The remaining question to be determined in this case is, therefore, whether there is a cause of action as for a libel set forth in the declaration. The article complained of as libelous was as follows:

"Mr. Chas. H. Behre is no longer connected with the National Cash Register Company, and has not been since August, 1893. Any contracts made by him for the company will be void. (Signed) J. Block, Agent, National Cash Register Company."

It was alleged that this notice was published in a newspaper in Albany, Georgia, and that a similar publication appeared in a newspaper in Atlanta, Georgia. It was further alleged, "that these publications were made for the purpose of injuring petitioner in his business by bringing him into discredit by making the public believe that he was undertaking to act as the agent of the said defendant, when in fact he was doing nothing of the kind, but was keeping as far aloof from them and their affairs as possible; and that the motive of the said defendant was to put him in a false attitude before the business public, by creating the impression that he was trying to act as their agent without authority \* \* \* and was part of a general plan and purpose of said defendant to injure him in his business and bring him into disrepute; and that they were inspired and made by said defendant for that purpose." The words complained of may be literally true—the statement in the first sentence as a matter of fact, and the statement in the second sentence as a matter of law. If the words were published in good faith for the purpose of protecting the interest of the defendant, no liability would flow from their publication. They are not libelous per se; but the averment as to the intention with which the defendant caused them to be published, and the effect which they have upon any one reading them, makes them libelous. The impression created upon the mind of any one reading this notice, is, that the plaintiff is seeking to impose himself upon the trading public as the agent of the defendant, and that through that means he is attempting to defraud the persons with whom he comes in contact, in connection with the sale of the goods of the character sold by the defendant. The distinct allegation being that this was false, and the words quoted above being in effect an allegation of malice, the petition sets forth a cause of action.

In the case of D. D. Maynard v. Fireman's Fund Insurance Company, 47 Cal. 207, the words complained of were: "This company for good and sufficient reasons has resolved to dismiss D. D. Maynard from its service." The court in the opinion say: "Words, which on

their face appear to be entirely harmless, may, under certain circumstances, convey a covert meaning, wholly different from the ordinary and natural interpretation usually put upon them. To render such words actionable, it is necessary for the pleader to aver that the author of the libel intended them to be understood, and that they were in fact understood by those who read them in their covert sense." The definition of libel in the law of this state is as follows: "A libel is a false and malicious defamation of another, expressed in print, or writing, or pictures, or signs, tending to injure the reputation of an individual, and exposing him to public hatred, contempt or ridicule." Civil Code, § 3832. The plaintiff's petition showing that he was engaged in the business of selling cash registers, there can be no question but that the words complained of, when published with the intention alleged, tended to injure the reputation of the plaintiff, and also to expose him to the hatred, contempt and ridicule of the business public.

There was no error in sustaining the demurrer to so much of the petition as attempted to set forth a cause of action for slander, but the demurrer should have been overruled as to the paragraphs referring to the libel complained of.

*Judgment reversed. All the justices concurring.*

*Note.* (1) *Libel.* That a corporation is civilly liable for libel is well settled: 1858, Phil., W. & B. R. Co. v. Quigley, 21 How. (62 U. S.) 202; 1867, Maynard v. Ins. Co., 34 Cal. 48, 91 Am. Dec. 672; 1875, Vinas v. Ins. Co., 27 La. Ann. 367; 1877, Machine Co. v. Souder, 58 Ga. 64; 1877, Johnson v. Dispatch Co., 65 Mo. 539, 27 Am. Rep. 293; 1881, McDermott v. Evening Journal, 14 Vroom 488, 15 Vroom 430, 39 Am. Rep. 606, 43 Am. Rep. 392; 1882, Southern Express Co. v. Fitzner, 59 Miss. 581, 42 Am. Rep. 379; 1882, Evening Journal Assn. v. McDermott, 15 Vroom (44 N. J. Law) 430, 43 Am. Rep. 392; 1884, Bacon v. Railroad Co., 55 Mich. 224, 54 Am. Rep. 372; 1889, Fogg v. Boston, etc., R. Co., 148 Mass. 513, 12 Am. St. Rep. 583; 1889, Missouri Pac. R. Co. v. Richmond, 73 Texas 568, 15 Am. St. Rep. 794, 4 L. R. A. 280; 1892, Belo v. Fuller, 84 Texas 450, 31 Am. St. Rep. 75; 1896, Hoboken Printing Co. v. Kahn, 59 N. J. Law 218, 59 Am. St. Rep. 585; 1899, Washington G. L. Co. v. Lansden, 172 U. S. 534, 19 Sup. Ct. Rep. 296.

*Compare*, 1891, Henry v. Railroad Co., 139 Pa. St. 289, 21 Atl. Rep. 157.

(2) *Slander:* There is an old rule that slander can not be committed by a deputy or agent so as to make the principal liable: Townsend, Libel and Slander, § 265, 7 Am. & E. Enc., 2d ed., 833. But in Reddit v. Singer Mfg. Co., 124 N. C. 100, 32 S. E. Rep. 392 (1899), a charge to the jury that "a corporation is responsible for slanderous words uttered by its agent in the course and scope of such agent's employment, and in aid of the company's interest," was held erroneous, mainly because there was no allegation nor any proof of authority or ratification. The court intimated that had such allegation and proof existed, the corporation could be held liable.

In 1887, Gilbert v. Crystal Fountain Lodge, 80 Ga. 284, on 286, 12 Am. St. 255, Mr. Chief Justice Bleckley says: "Whether a partnership can slander anybody might formerly have admitted of some question; for it is an old rule, going back to Croke's reports—perhaps further still—that there could be no joint action against several persons for oral words. The courts considered that if two uttered the same words simultaneously, the vocal act of each would have a separate identity, and be an individual act; and so actions for such torts ought to be several and not joint. \* \* \* On principle, we can think of no reason why a partnership might not slander a third person through agents or members, authorized to defame orally; or by adoption and ratification, after defamation by slanderous words." And in 1889, Haney Mfg. Co. v. Perkins,

78 Mich. 1, on p. 9, Judge Long says: "Each of the partners is an agent of the partnership as an entirety, and if in the course of that business he injures the business of another by slander, the partnership is liable therefor, just as it might be for any other tort by any other agent;" but the cases he cites, 17 Mass. 182, 133 Mass. 431, 83 Ala. 404, do not so hold as to *slander*. The following cases indicate that a corporation is liable for slander: 1880, Dodge v. Bradstreet, 59 How. Pr. (N. Y.) 104; 1886, Buffalo Lub. Oil Co. v. Standard Oil Co., 42 Hun (N. Y.) 153, on 157; 1887, Hussey v. Norfolk So. R., 98 N. C. 34, 2 Am. St. Rep. 312.

See also, 1891, Schafner v. Ehemann, 139 Ill. 109; 1895, Atlanta Nat'l Bk. v. Davis, 96 Ga. 334; 1896, Mt. Sterling, etc., Bank v. Green, 99 Ky. 262; 1896, Svensden v. Bank, 64 Minn. 40; 1899, First Nat'l Bk. v. Railsback Bros., etc., 58 Neb. 248; *compare*, 1894, Bank of Commerce v. Goos, 39 Neb. 437.

## Sec. 395. (7) Malicious prosecution.

### GOODSPEED v. EAST HADDAM BANK.<sup>1</sup>

1853. IN THE SUPREME COURT OF CONNECTICUT. 22 Conn. 530,  
58 Am. Dec. 439.

CHURCH, C. J. This action is based upon the provisions of our statute, entitled, "An act to prevent vexatious suits," and is subject to the same general principles as are actions on the case for malicious prosecutions, at common law.

The plaintiff alleges that the defendants, the East Haddam Bank, a body politic and corporate, without probable cause, and with a malicious intent unjustly to vex, harass, embarrass and trouble the plaintiff, commenced by a writ of attachment, and prosecuted against him, a certain vexatious suit or action for fraudulent representations, to the injury of said bank, and which action resulted in a verdict and judgment against the bank, and in favor of the present plaintiff.

On the trial of this cause, by the superior court, the defendants moved for a nonsuit, on the ground that the plaintiff by his evidence had failed to make out a *prima facie* case; which motion the court granted, and judgment of nonsuit was entered against the plaintiff, which he now moves to set aside.

The judgment of the superior court, in granting the nonsuit, as we understand, was founded solely upon the ground that a corporation aggregate was not, by law, liable for such a cause of action as was set up by the plaintiff, in his declaration—at least, no other ground of nonsuit or objection to the plaintiff's action has been argued before us. And, therefore, irrespective of the evidence detailed in the motion, we confine ourselves to what we suppose to be the sole question in the case.

We assume that the plaintiff has sustained the damage he claims, by reason of the prosecution of the vexatious suit, and the question is, has he a legal remedy against the bank?

The claim of the defendants is that the remedy for this injury is to

<sup>1</sup> Statement, except as in the opinion, arguments, and dissenting opinion of Ellsworth, J., omitted.

be sought against the directors of the bank, or the individuals, whoever they might have been, by whose agency the vexatious suit was prosecuted, and not against the corporation. We think, that, to turn the plaintiff round to pursue the proposed remedy would be trifling with him and with his just rights, and would be equivalent to declaring him remediless; and, in this case, at least, that there was a wrong where there is no remedy. It is notorious that, ordinarily, the action of bank directors is private—that their records do not disclose the names of the individuals supporting or opposing any resolution or vote, and if they do, that the offending persons may be irresponsible and insolvent. The language of Tilghman, C. J., in a case very similar to the present, in which it was urged that a corporation was not liable for a suit, but only the individuals committing it, is applicable here. “This doctrine,” he said, “was fallacious in principle and mischievous in its consequences, as it tends to introduce actual wrongs and ideal remedies, for a turnpike company might do great injury, by means of laborers having no property to answer damages,” etc. (4 Serg. & Rawle, 16). To the same effect is the language of Shaw, C. J., in the case of *Thayer v. Boston* (19 Pick. 511). He says: “The court are of opinion that this argument, if pressed to all its consequences, and made the foundation of an inflexible practical rule, would often lead to very unjust results.”

Still more explicit is the opinion of the court in the case of *The Life and Fire Insurance Company v. Mechanics' Fire Insurance Company* (7 Wend. 31). There, as here, it was contended that the act was unauthorized, and must, therefore, be considered as the act of the officers of the company, and not of the company itself. And the court says: “This would be a most convenient distinction for corporations to establish: that every violation of their charter or assumption of unauthorized power, on the part of their officers, although with the full knowledge and approbation of the directors, is to be considered the individual act of the officers, and is not to prejudice the corporation itself. There would be no possibility of ever convicting a corporation of exceeding its powers, and thereby forfeiting its charter, or incurring any other penalty, if this principle could be established.”

The real nature, as well as the law, of corporations, within the last half century, has been in a progress of development, so that it has grown up, from a few rules and maxims, into a code. In the days of Blackstone, the whole subject of corporations, and the laws affecting them, were discussed within the compass of a few pages; now volumes are required for this purpose. These institutions have so multiplied and extended within a few years, that they are connected with, and in a great degree influence, all the business transactions of this country, and give tone and character, to some extent, to society itself. We do not complain of this; but we say, that, as new relations from this cause are formed, and new interests created, legal principles of a practical rather than of a technical or theoretical character, must be applied.

And so, in the course of this progress, it has been. It was said by Lord Coke, "that corporations had neither souls nor bodies;" and by somebody else, "that they had no moral sense;" and from thence, or for some other equally insufficient reason, it was inferred, and so repeatedly adjudged, that they could not be subjected in actions of trover, trespass, or disseizin, and indeed, that they could not commit wrongs, nor be liable for torts, with a few exceptions, as we shall see.

Had Lord Coke lived in this age and country, he would have seen, that corporations, instead of being the soulless and unconscious beings he supposed, are the great motive powers of society, governing and regulating its chief business affairs; that they act, not only upon pecuniary concerns; but, as having conscience and motives, to an almost unlimited extent, they are entrusted with the benevolent and religious agencies of the day, and are constituted trustees and managers of large funds promotive of such objects.

The views of the old lawyers regarding the real nature, power, and responsibilities of corporations, to a great extent are exploded in modern times, and it is believed, that now these bodies are brought to the same civil liabilities as natural persons, so far as this can be done practically, and consistently with their respective charters. And no good reason is discovered why this should not be so; nor why it can not be done, in a case like this, without violating any sensible or useful principle.

And although it was truly said, and for obvious reasons, that corporations could not be punished corporally, as traitors or felons, yet they may be, and have often been, subjected to fines and forfeitures, for malfeasance, and even to the loss of corporate life, by the revocation of their charters. And now it seems to be generally admitted, that they are civilly responsible, in their corporate capacities, for all torts which work injury to others, whether acts of omission or commission; for negligence merely, and for direct violence. *Yarborough v. Bank of Eng.*, 16 East 6; *Beach v. Fulton Bank*, 7 Cowen 486; *Foster v. Essex Bank*, 17 Mass. 503; *Riddle v. Proprietors of Locks and Canals*, 7 Mass. 187; *Chestnut Hill Turnpike v. Rutter*, 4 Serg. & Rawle 16; 4 Hammond 500, 514; 10 Ohio Rep. 159; *Dater v. Troy Turnpike Co.*, 2 Hill 630; 23 Pick. 139; 2 Bl. Com. 476; Ang. & Ames 392; 2 Kent Com. 290; 1 Sw. Dig. 75; 15 Ohio Rep. 476; 18 Ohio Rep. 229. And indeed, no actions are now more frequent, in our courts, than such as are brought against corporations, for torts, either in case or trespass. *Hooker v. New Haven & Northampton Canal Co.*, 14 Conn. 146, and the cases there cited, and many others since reported. In a late case in England, it has been adjudged, adversely to former opinions, that an action of assault and battery may be sustained against a corporation. *Eastern Counties Railway Co. v. Broom*, 2 Eng. Law & Equity 406. And it was decided long ago, that a corporation was liable to an action for a false return to a writ of mandamus, alleged to have been made falsely and maliciously. 16 East 8, 14 Eng. Com. Law 159, 3 Mees. & Wels. 244, Ang. & Ames, ch. 10, section 9.



In all the cases, wherein it has been holden that corporations may be subjected to civil liabilities for torts, the acts charged as such have been the acts of their constituted authorities—either the directors, or agents, or servants, employed by them. We do not intend here to discuss or decide the frequently suggested question, how far, or when a principal, whether an individual person or a corporation, becomes responsible for the willful or malicious act of his servant or agent, as distinguished from his mere negligence, although it has been brought into the argument of this case, because we do not admit that the present case falls within the operation of the rule of law on this subject, even as the defendants claim it.

The truth is, the action complained of as vexatious was instituted by the bank, in the name of the bank, and, as should be presumed, in just the same way and by the same agencies and means, as all other suits by these institutions are commenced and prosecuted, and nothing appears here, showing any different procedure than is usual, in actions by corporations. The action was brought for the sole benefit of the bank, for the recovery of money to which the bank was entitled, if anybody, and for an injury sustained by the bank in its corporate capacity. The bank, by its charter and the general laws, had power to sue for such a cause of action; and what seems to us yet more conclusive, is, that if this suit was originated by the misconduct of directors, or any officer of the company, it has never been repudiated, and may, by the acquiescence of the bank, be considered as sanctioned by it. Ang. & Ames, ch. 10, section 9. No act of agency appears here, which does not appear in all suits brought by corporations, and nothing to show that any individuals are, or ought to be, made responsible for the institution and prosecution of the groundless suit, as distinct from the corporation itself.

The doctrine, that principals are not responsible for the willful misconduct of their agents, as seems to have been sanctioned in the cases of *McManus v. Crickett*, 1 East 106; *Wright v. Wilcox*, 19 Wend. 343; *Vanderbilt v. Richmond Turnpike Co.*, 2 Comstock 479; but denied by Chief Justice Reeve in his *Domestic Relations*, 357, we think, has never been applied to such a case as this, but only to the acts of agents or servants, properly so called; or such as act under instructions and a delegated authority—persons whose duty it is to obey, not to control; as attorneys, cashiers, or others employed by the corporation. The president and directors of a bank, instead of being mere servants, are really the controlling power of the corporation—the representatives, standing and acting in the place of the interested parties. Indeed, they are the mind and soul of the body politic and corporate, and constitute its thinking and acting capacity. In the case of *Burrell v. The Nahant Bank*, 2 Met. 163, Shaw, C. J., expresses and defines the true rule of appreciating the character and powers of bank directors. He says: “We think the exception takes much too limited and strict a view of the powers of bank directors. A board of directors is a body recognized by law. By the laws of these corporations, and by the usage, so general and uniform as to be regarded



as a part of the law of the land, they have the general superintendence and active management of all the concerns of the bank, and constitute, to all purposes of dealing with others, the corporation. We think they do not exercise a delegated authority in the sense to which the rule applies to agents and attorneys," etc. The same principle is very distinctly recognized, in the cases of *Bank Commissioners v. Bank of Buffalo*, 6 Paige's Ch. 502, and *Life and Fire Ins. Co. v. Mechanics' Fire Ins. Co.*, 7 Wend. 31. It has been said, that the stockholders constitute the corporation. It may be so, to the extent to which they have the power to act—and this is only in the choice of directors, and no more. Beyond this, they can only be considered as the persons for whose ultimate individual interest the corporation acts. The directors derive all their power and authority from the charter and laws, and none from the stockholders.

But the fear is expressed, that, by thus considering and treating the character and acts of the directors of a bank or other corporation, the stockholders are subject to loss, without fault of their own. This may to some extent be true; but the protection of the law in this matter is not to be confined to stockholders; the public and strangers have rights also. The stockholders are volunteers, and they have consented to assume the risk of the faithful or unfaithful management of the corporation. If, in this case, one of two innocent persons or classes is to suffer, which should it be—that one which is brought in to suffer loss, without its consent or power to prevent it, or the one which has created the power and selected the persons to enforce it?

But, after all, the objection to the remedy of this plaintiff against the bank, in its corporate capacity, is not so much, that, as a corporation, it can not be made responsible for torts committed by its directors, as that it can not be subjected for that species of tort which essentially consists in motive and intention. The claim is, that, as a corporation is ideal only, it can not act from malice, and therefore can not commence and prosecute a malicious or vexatious suit. This syllogism, or reasoning, might have been very satisfactory to the school men of former days; more so, we think, than to the jurist who seeks to discover a reasonable and appropriate remedy for every wrong. To say that a corporation can not have motives, and act from motives, is to deny the evidence of our senses, when we see them thus acting, and effecting thereby results of the greatest importance every day. And if they can have any motive, they can have a bad one—they can intend to do evil as well as to do good. If the act done is a corporate one, so must the motive and intention be. In the present case, to say that the vexatious suit, as it is called, was instituted, prosecuted and subsequently sanctioned, by the bank, in the usual modes of its action, and still to claim that, although the acts were those of the bank, the intention was only that of the individual directors, is a distinction too refined, we think, for practical application.

It is asked, how can the malice of a corporation be proved? It must be proved, it is said, as well as alleged, in an action for a ma-

licious prosecution as a distinct and essential fact; and the declarations and admissions of individual members, whether directors or others, are not admissible to prove it. True, malice must be proved, and, as we suppose, very much in the same manner as it is proved in other cases of a similar nature, against individual persons. The want of probable cause of action is proof of malice, and for aught we know, also, the records of the bank may show it. It is enough to say, in this, as in all other cases, that if the plaintiff can not, in some legitimate way, prove the malice he has alleged, he can not recover; but we have no right to assume it as a legal principle that it can not be proved. We do not know that it has ever been adjudged that a corporation is civilly responsible for a libel. But, among the great variety and objects of these institutions, it is probable that the newspaper press has come in for its share of the privileges supposed to be enjoyed under corporate powers. Proof of the falsehood of slanderous charges is evidence of malice, and which must, as in this case, be proved; but would it be endured that an association, incorporated for the purpose suggested, could, with impunity, assail the character and break down the peace and happiness of the good and virtuous, and the law afford no remedy, except by a resort to insolvent and irresponsible typesetters, and for no better reason than that a corporation is only an ideal something, of which malice or intention can not be predicated? And, if, as we have suggested, the directors are, for all practical purposes, the corporation itself, acting at least as its representatives, we can see no greater difficulty in proving their motives good or bad, than in thus proving the motives of other associated or conspiring bodies. We are sure that this objection of the defendants was not discovered, or was not regarded as sufficient, nor the difficulty of proving malice upon a corporation felt, when the case of *Merrills v. The Tariff Manufacturing Co.*, 10 Conn. R. 384, was tried at the circuit, and discussed and decided by this court. That was an action against a corporation for a malicious injury, and the sole question in this court was, whether, by reason of the malicious intent, the company was liable for aggravated or vindictive damages; and it was holden to be thus liable, in a very elaborate opinion drawn up and strongly expressed by Huntington, J.

The interests of the community and the policy of the law demand that corporations should be divested of every feature of a fictitious character, which shall exempt them from the ordinary liabilities of natural persons, for acts and injuries committed by them and for them. Their immunities for wrongs are no greater than can be claimed by others, and they are entitled to an equal protection for all their rights and privileges, and no more.

For the reasons suggested, a majority of the court is of opinion that the nonsuit granted by the superior court should be set aside, and a new trial granted.

In this opinion Waite, J., concurred; Ellsworth and Hinman, J. J., dissent.

*Accord:* 1867, *Vance v. Erie R. Co.*, 3 Vroom (N. J.) 334, 90 Am. Dec. 665; 1872, *Wheless v. Second Nat'l Bk.*, 1 Baxter (Tenn.) 469, 25 Am. Rep. 783; 1875, *Copley v. Machine Co.*, Fed. Cas. 3218; 1878, *Carter v. Howe Machine Co.*, 51 Md. 290, 34 Am. Rep. 311; 1880, *Williams v. Planters' Ins. Co.*, 57 Miss. 759, 34 Am. Rep. 494, *note*; 1880, *Ricord v. Railroad Company*, 15 Nev. 167; 1881, *Reed v. Home Sav. Bk.*, 130 Mass. 443, 39 Am. Rep. 468; 1882, *Boogher v. Life Assn.*, 75 Mo. 319, 42 Am. Rep. 413; 1883, *Jordan v. Alabama & G. S. R. Co.*, 74 Ala. 85, 49 Am. Rep. 800; 1884, *Pennsylvania Company v. Weddle*, 100 Ind. 138; 1884, *Hussey v. Norfolk & S. R. Co.*, 98 N. C. 34, 2 Am. St. Rep. 312; 1900, *Walker v. Culman*, 9 Kan. App. 691, 59 Pac. Rep. 606; *contra*, 1874, *Gillett v. Missouri, etc., R. Co.*, 55 Mo. 315, 17 Am. Rep. 653.

**Sec. 396. (8) Fraud, deceit and conspiracy.**

**JOHNSTON FIFE HAT COMPANY v. THE NATIONAL BANK OF GUTHRIE.<sup>1</sup>**

1896. IN THE SUPREME COURT OF OKLAHOMA. 4 Oklahoma Rep. 17-35, 3 A. & E. C. C. N. S. 307.

BURFORD, J.: This is an appeal from a judgment sustaining a demurrer to plaintiff's complaint. The plaintiffs brought their action in the district court of Logan county, to recover judgment against the defendant, together with certain other defendants, in which complaint they alleged that the defendants had entered into a conspiracy by which the plaintiffs were defrauded in the sale of certain merchandise. \* \* \*

The defendants demurred upon the ground that the same did not state facts sufficient to constitute a cause of action against either of them. The court sustained the demurrer, and the plaintiffs declining to plead further, judgment was rendered in favor of the defendants.

The only question presented is as to the sufficiency of the complaint to constitute a cause of action against the defendant, the National Bank of Guthrie.

The action is one *ex delicto* to recover damages for a tort alleged to have been committed by a national banking corporation, acting by and through its president and general agent.

It is contended by counsel for the bank, that the president of the bank had no authority, either in law or fact, to do the acts alleged to have been done by him for the bank, and that his acts were not the acts of the bank as a corporation for which it is in any form of action liable, and in support of this contention it is argued that a national bank has no authority to purchase merchandise; to engage in the mercantile business, or to assist others in the purchase of such goods, and hence, if the president of the bank entered into any conspiracy to aid the Melone Brothers in defrauding plaintiffs as alleged in the complaint, that he was then acting without the scope of his authority as an officer of the bank and outside its chartered powers, and hence

<sup>1</sup>Statement of facts except as appearing in opinion omitted.

the bank is not liable for such actions on his part. This is an adroit evasion of the effect of the allegations of the complaint.

It is conceded by counsel for the bank, "that for acts done by the agents of a corporation, either *ex contractu* or *ex delicto*, in the course of its business and of their employment, the corporation is responsible as an individual is responsible under similar circumstances." Applying this rule to the allegations of the complaint, we think it states a good cause of action against the bank. It is within the power of the bank to loan money, to take mortgages on chattels as security for such loans, to foreclose its mortgages and to sell the mortgaged chattels to pay its lien. It is within the employment of the president of the bank, who has the active management of its business, to make loans for the bank, to take security for it, and to take any necessary steps for the protection of its funds loaned or on hand, and in carrying out any of these functions the bank is bound by his acts. If, in performing any of the duties incident to such employment, he perpetrates a fraud or commits a tort, the bank is liable for such acts.

Applying these observations to the facts alleged in the complaint, it becomes apparent that a good cause of action is set up.

It is alleged in substance that Melone Brothers were engaged in the mercantile business; that they entered into an agreement with the president of the bank that they should purchase a large stock of goods on credit amounting to several thousand dollars; that the bank would loan them about one thousand dollars, and after the stock arrived, which was to be purchased under this agreement and before the bills for same became due, that Melone Brothers should execute a chattel mortgage to the bank for \$10,000; that the bank would foreclose the mortgage, sell the stock and divide the proceeds with Melone Brothers, and leave the creditors unpaid. In pursuance of this agreement, it is alleged that Melone Brothers purchased the goods in question from plaintiffs; that they made other purchases in pursuance of the conspiracy; that the bank loaned them from \$1,000 to \$1,500; that the chattel mortgage was executed, the goods taken by the bank and sold for \$5,300, which the bank received, or took a note for. This amounted to a conspiracy to defraud plaintiffs, and it was not necessary, in order to render the bank liable in tort, that it should have authority to take each particular step required to consummate the fraud. It is sufficient to charge the bank that it took part in the conspiracy, knowing its purpose. This it did by taking the mortgage; by seizing and selling the goods; by appropriating the proceeds and thus aiding in the fraudulent design and purpose.

When one joins an unlawful conspiracy after it has been formed, at any period, and in the least degree acts in concert or collusion with the conspirators, their acts become his by adoption and the acts of one the act of all. (4 Am. and Eng. Enc. Law, p. 622, and cases cited.)

We have thus far treated this case upon the theory of the law as presented by counsel for the defendant. By the weight of modern authority this rule has been extended and made to embrace a larger

number and different class of cases than was originally within its scope.

In the *National Bank v. Graham*, 100 U. S. 699, Mr. Justice Swayne, in speaking of the liability of corporations for torts, said:

"Corporations are liable for every wrong they commit, and in such cases the doctrine of *ultra vires* has no application. They are also liable for the acts of their servants while such servants are engaged in the business of their principal, in the same manner and to the same extent that individuals are liable under like circumstances. (*Merchants' Bank v. State Bank*, 10 Wall. 604.) An action may be maintained against a corporation for its malicious or negligent torts, however foreign they may be to the object of its creation or beyond its granted powers. It may be sued for assault and battery, for fraud and deceit, for false imprisonment, for malicious prosecution, for nuisance and for libel. In certain cases it may be indicted for misfeasance or non-feasance touching duties imposed upon it in which the public are interested. Its offenses may be such as will forfeit its existence."

The court of appeals of New York, in the case of *Craigie v. Hadley*, 99 N. Y. 131, 1 N. E. Rep. 537, in discussing the extent to which a corporation may be held liable for the fraud of its officers or agents, said:

"A corporation may be, in a legal sense, guilty of a fraud. As a merely legal entity it can have no will, and can not act at all, but in its relation to the public it is represented by its officers and agents, and their fraud, in the course of the corporate dealings, is in law the fraud of the corporations. There is more difficulty in establishing a fraud against a corporation than against an individual. This arises from the difficulty, in many cases, of determining whether the fraud charged is imputable to the corporation. There may be knowledge of a fact by an agent of a corporation which, if brought home to the corporation itself, would create responsibility in a given case, but as to which notice will not be imputed to the corporation merely from the fact that it was known by the agent. We need not enter into the distinctions upon this subject. But the general rule is well established that notice to an agent of a bank, or other corporation intrusted with the management of its business, or of a particular branch of its business, is notice to the corporation, in transactions conducted by such agent, acting for the corporation, within the scope of his authority, whether the knowledge of such agent was acquired in the course of the particular dealing, or on some prior occasion."

In *Western News Co. v. Wilmarth*, 33 Kans. 510, 6 Pac. Rep. 786, the supreme court of Kansas states the rule as laid down by Judge Cooley:

"It is contended that the trial court erred in overruling the demurrer to the petition, for the reason that 'corporations are not liable for torts where the ground of legal responsibility is evil motive.' The law is otherwise. 'Corporations are responsible for the wrongs committed or authorized by them, under substantially the same rules which govern the responsibility of natural persons. It was formerly supposed

that those torts which involve the element of evil intent, such as batteries, libels and the like, could not be committed by corporations. Inasmuch as the state, in granting rights for lawful purposes, had conferred no power to commit unlawful acts, such torts committed by corporate agents must consequently be *ultra vires*, and the individual wrongs of the agents themselves; but this idea no longer obtains.' (Cooley Torts, 119.)"

The supreme court of North Carolina adopts the same rule in *Peebles v. Patapsco Guano Co.*, 77 N. C. 233:

"There is no reason that occurs to us why a different rule should be applicable to cases of deceit from what applies to other torts. A corporation can only act through its agents, and must be responsible for their acts. It is of the greatest public importance that it should be so. If a manufacturing and trading corporation is not responsible for the false and fraudulent representations of its agents, those who deal with it will be practically without redress, and the corporation can commit fraud with impunity."

In the case of *Fogg et al. v. Griffin et al.*, 2 Allen 1, the supreme court of Massachusetts discusses this question at some length, and well states the rule which is applicable to the case at bar. Chief Justice Bigelow says:

"If it be true, as urged by the counsel for the plaintiffs, that he could not bind the corporation by any false and fraudulent representations, because it had no authority to appoint an agent for an unlawful purpose or to use unlawful means, it would follow that no corporation could be held liable for any acts of its authorized agents, however fraudulent or wicked their conduct might be, or however great might be the injury thereby occasioned to third persons. Such a doctrine finds no support in the law. A corporation can act only through agents. If they, while exercising the authority conferred on them, are guilty of falsehood and fraud, their principal is liable for the consequences which may flow therefrom. The true test of the liability of the principal in such cases is to ascertain whether, in committing a fraud, the agent was acting in the business of his principal. If he was engaged in the course of his employment, then parties injured by his misconduct or fraud can resort for redress to the persons who clothed him with the power to act in their behalf, and who have received the benefits resulting from his agency. (*Foster v. Essex Bank*, 17 Mass. 479, 509.)" \* \* \*

[The court then quoted extensively from *Goodspeed v. East Had-dam Bank*, 22 Conn. 530, *supra*, and *Nims v. Mount Hermon Boys' School*, 160 Mass. 177, 22 L. R. A. 364, *infra*].

This same doctrine is upheld by the supreme court of the United States in *Salt Lake City v. Hollister*, 118 U. S. 256, Mr. Justice Miller delivering the opinion. The city of Salt Lake had set up a distillery, and for some time had been engaged in the business of distilling and producing spirits. Hollister, as collector of internal revenue, collected from the city the sum of \$12,057.75, as revenue on the



spirits distilled. The city sued to recover this fund as being illegally exacted from the city treasury.

It was contended on behalf of the city that, under its corporate powers, it was unauthorized to engage in the distilling business, and the acts of its officers were *ultra vires*, and that the city was not liable for the tax upon the spirits so unlawfully manufactured by its officers and agents. The supreme court held the city liable for the tax, and the learned justice said:

"But while the city does not deny the actual fact of distillation, and of fraudulent returns by it, it denies the whole affair by argument. It says that, though it is very true the city did distill spirits, did sell them, and did receive the money into its treasury, it can not be held liable for this because it had no legal power to do so. Its want of corporate authority to engage in distilling is to be received as conclusive evidence that it did not do so, while by the pleading it is admitted that it did. Because there was no statute which authorized it as a city of Utah to distill spirits, it could engage in this profitable business to any extent without paying the taxes which the laws of the United States require of every one else who did the same thing.

"If the territory of Utah had added to its other corporate powers that of making and selling distilled spirits, then the city would be liable to the tax, but because it had no such power by law, it could do it without any liability for the tax to the United States or to any one else.

"It would be a fine thing, if this argument is good, for all distillers to organize into milling corporations to make flour, and proceed to the more profitable business of distilling spirits, which would be unauthorized by their charters or articles of incorporation, for they would thus escape taxation and ruin all competitors.

"It is said that the acts done are not the acts of the city, but of its officers or agents who undertook to do them in its name. This would be a pleasant farce to be enacted by irresponsible parties, who give no bond, who have no property to respond to civil or criminal suits, who make no profit out of it, while the city grows rich in the performance. It is to be taken as a fair inference on this demurrer that all that the city might have done was done in establishing this business. The officers who, it is said, did this thing, must be supposed to have been properly appointed or elected. Resolutions or ordinances of the governing body of the city directing the establishing of the distillery and furnishing money to buy the plant, must be supposed to have been passed in the usual mode. Everything must have been done under the same rules and by the same men as if it were a hospital or a town hall. If the demurrer had not admitted this, it could no doubt have been proved on an issue denying it. •

"But the argument is unsound that whatever is done by a corporation in excess of the corporate powers, as defined by its charter, is as though it was not done at all. A railroad company authorized to acquire a right of way by such exercise of the right of eminent domain as the law prescribes, which undertakes to and does seize upon and

invade, by its officers and servants, the land of a citizen, makes no compensation, and takes no steps for the appropriation of it, is a naked trespasser, and can be made responsible for the tort. It had no authority to take the man's land or to invade his premises. But if the governing board had directed the act, the corporation could be sued for the tort, in an action of ejectment, or in trespass, or on an implied assumpsit for the value of the land. A plea of *ultra vires*, in this case, would be no defense.

“The truth is, that, with the great increase in corporations in very recent times, and in their extension to nearly all the business transactions of life, it has been found necessary to hold them responsible for acts not strictly within their corporate powers, but done in their corporate name, and by corporation officers who were competent to exercise all the corporate powers. When such acts are not founded on contract, but are arbitrary exercises of power in the nature of torts, or are *quasi*-criminal, the corporation may be held to a pecuniary responsibility for them to the party injured.”

The foregoing observations are peculiarly applicable to the case under consideration. The bank took and accepted the mortgage, according to DeSteiguer's fraudulent agreement with Melone. It took possession of the goods that Melone had procured under the dishonest scheme agreed to by its president. It sold the goods that had been procured pursuant to the fraudulent design. It accepted the proceeds of the sale as the fruits of the fraud, and now seeks to escape liability upon the ground that its president was acting without his lawfully constituted authority. Courts can not lend themselves to aid corporations in holding on to money received in such a manner, and under such circumstances. When the bank accepted the results of DeSteiguer's fraudulent schemes, it became equally liable with him and jointly liable for his acts, and under the facts alleged, plaintiffs are entitled to recover the value of their goods from any and all of the tort-feasors.

It is contended by counsel for defendant that the goods belonged to Melone Brothers, and they had a right to take the mortgage as security, and to sell the same for the payment of their claim. This contention is based upon a false assumption. The title to the goods, under the facts alleged in the complaint, which are confessed by the demurrer, never passed to Melone Brothers, and they could convey none by the mortgage to the bank, for it had notice through its manager of all the facts constituting the fraud, and their seizure of the goods amounted to a conversion for which they are liable to the owners.

It may be urged that the stockholders of the corporation ought not to be held to a loss on account of the unauthorized acts of DeSteiguer. But the answer to this is, they placed him in this position; they intrusted their interests to his management and keeping, and if in carrying on their business he perpetrated a fraud upon innocent persons, they who made it possible for him to perpetrate the fraud must suffer, rather than those who are in no wise responsible for his actions.

The judgment of the district court is reversed with direction to overrule the defendant's demurrer to the complaint, and for further proceedings.

Dale, C. J., having presided in the court below, and Bierer, J., having been of counsel, not sitting; all the other justices concurring.

*Note.* Fraud and deceit: *Accord*, 1846, Bartholomew v. Bentley, 15 Ohio 659, 45 Am. Dec. 596; 1869, McClellan v. Scott, 24 Wis. 81; 1877, Peebles v. Patapsco Guano Co., 77 N. C. 233, 24 Am. Rep. 447; 1884, Erie City Iron Works v. Barber, 106 Pa. St. 125, 51 Am. Rep. 508; 1885, Cragie v. Hadley, 99 N. Y. 131; 1894, Dorsey Machine Co. v. McCaffrey, 139 Ind. 545, 47 Am. St. Rep. 290; 1897, Breyfogle v. Walsh, 80 Fed. Rep. 172; 1899, Hindman v. First Nat'l Bank, 39 C. C. A. 1, with *note*; 1903, Taylor v. Bank, 173 N. Y. 181.

Conspiracy: *Accord*, 1880, Dodge v. Bradstreet Co., 59 How. Pr. (N. Y.) 104; 1887, Buffalo Lub. Oil Co. v. Standard Oil Co., 106 N. Y. 669; 1894, Dorsey Machine Co. v. McCaffrey, 135 Ind. 545, 47 Am. St. Rep. 290; 1899, Zink Carb. Co. v. First Nat'l Bank, 103 Wis. 125, 74 Am. St. Rep. 845, 79 N. W. Rep. 229; 1901, West Virginia Trans. Co. v. Standard Oil Co., 50 W. Va. 611, 40 S. E. 591, 56 L. R. A. 804.

### Sec. 397. (9) Negligence—*Ultra vires* torts.

#### KIRK E. NIMS v. MT. HERMON BOYS' SCHOOL.

1893. IN THE SUPREME JUDICIAL COURT OF MASSACHUSETTS. 160  
Mass. Rep. 177-182, 39 Am. St. Rep. 467, 22 L. R. A. 364.

KNOWLTON, J. The defendant is an educational corporation. The plaintiff seeks to recover damages for an injury received through the negligence of a ferryman in managing a boat on which he was a passenger, and which, as he alleges, the defendant was using at a public ferry in the business of carrying passengers for hire. At the request of the defendant the presiding justice ruled that there was no evidence to warrant a finding for the plaintiff, and directed a verdict for the defendant. The defendant contends that the ruling should be sustained on one or both of two grounds. It says, in the first place, that if it maintained the ferry and hired and paid the ferryman, the business was *ultra vires*, and therefore it is not liable for negligence in the management of the boat. Secondly, it contends that there was no evidence to connect the corporation with the business of running the ferry-boat, or to show that the ferryman was its servant.

It is a general rule that corporations are liable for their torts as natural persons are. It is no defense to an action for a tort to show that the corporation is not authorized by its charter to do wrong. Recovery may be had against corporations for assault and battery, for libel and for malicious prosecution, as well as for torts resulting from negligent management of the corporate business. *Moore v. Fitchburg Railroad*, 4 Gray 465; *Reed v. Home Savings Bank*, 130 Mass. 443; *Fogg v. Boston & Lowell Railroad*, 148 Mass. 513; *Philadelphia, Wilmington & Baltimore Railroad v. Quigley*, 21 How. 202-209; *Merchants' Bank v. State Bank*, 10 Wall. 604; *National Bank v. Graham*, 100 U. S. 699; *Gruber v. Washington & Jamesville*

Railroad, 92 N. C. 1; Hussey v. Norfolk Southern Railroad, 98 N. C. 34. If a corporation by its officers or agents unlawfully injures a person, whether intentionally or negligently, it would be most unjust to allow it to escape responsibility on the ground that its act is *ultra vires*. The only plausible ground on which the defendant in the present case can contend that it should be exempt from liability for the negligence of its servant in managing the ferry-boat is that the contract to carry the plaintiff was *ultra vires*, and therefore invalid, and that the duty for neglect of which the plaintiff sues arose out of the contract, and disappears with it when the contract appears to be void. The defendant may argue that the plaintiff can not maintain an action for a breach of the contract to use proper care to carry him safely, and that he stands no better when he sues in tort for failure to do the duty which grew out of the contract.

In Bissell v. Michigan Southern & Northern Indiana Railroad, 22 N. Y. 258, the plaintiff founded his action on the negligence of the two defendants while jointly running cars on a railroad in a state to which the charter of neither of them extended, and it was conceded that the defendants were acting *ultra vires*. The plaintiff recovered, Comstock, C. J., holding in an elaborate opinion that the corporations were liable under their contract, notwithstanding that the contract was *ultra vires*, and that if they could not be held under their contract they could not be held at all, inasmuch as the only negligence alleged was a failure to use the care which the contract called for. Selden, J., in an equally full and elaborate opinion, held that the contract for carriage was invalid, and that there could be no recovery under it, nor for negligence founded upon it; but it was his opinion that, if the contract were set aside, the defendants owed the plaintiff a duty founded on his relation to them as an occupant, with their permission, of a place in their car, and that the improper management of the car was a neglect of that duty for which the plaintiff could recover. Clerke, J., agreed with this view, and all but one of the other judges concurred in a decision for the plaintiff, without stating the ground on which they thought the decision should be placed. This case was followed in Buffett v. Troy & Boston Railroad, 40 N. Y. 168, in which it was held that a railroad corporation was liable for negligence of the driver of a stage-coach which it was running without a legal right to do a business of that kind; but the opinion does not show whether the decision is founded on the opinion of Comstock, C. J., given in the former case, or on that of Selden, J. Like decisions have been made under similar facts in Central Railroad & Banking Co. v. Smith, 76 Ala. 572; New York, Lake Erie & Western Railway v. Haring, 18 Vroom 137, and Hutchinson v. Western & Atlantic Railroad, 6 Heisk. 634.

The better doctrine seems to be that a contract made by a corporation in violation of its charter, or in excess of the powers granted to it, either expressly or by implication, is invalid, considered merely as a contract, and so long as it is entirely executory, will not be enforced. It is not only a violation of a private trust, viewed in reference to the

stockholders, but it is against the policy of the law, which intends that corporations deriving their powers solely from the legislature shall not pass beyond the limits of the field of activity in which they are permitted by their charter to work. *Monument National Bank v. Globe Works*, 101 Mass. 57; *Attorney-General v. Tudor Ice Co.*, 104 Mass. 239; *Davis v. Old Colony Railroad*, 131 Mass. 258; *Thomas v. Railroad Co.*, 101 U. S. 71; *Leslie v. Lorillard*, 110 N. Y. 519; *Linkauf v. Lombard*, 137 N. Y. 417; *East Anglian Railways v. Eastern Counties Railway*, 11 C. B. 775, 803. On the other hand, courts have frequently held that, while such contracts considered merely as contracts are invalid, they involve no such element of moral or legal wrong as to forbid their enforcement if there has been such action under them as to work injustice if they are set aside. Courts have been astute to discover something in the nature of an equitable estoppel against one who, after entering into such a contract and inducing a change of condition by another party, attempts to avoid the contract by a plea of *ultra vires*. It is said that such a plea will not avail, when to allow it would work injustice and accomplish legal wrong. *Leslie v. Lorillard*, 110 N. Y. 519; *Linkauf v. Lombard*, 137 N. Y. 417, 423. Many cases might be supposed in which it would be most unjust to hold that one who had received the benefits of such a contract might retain them and leave the other party without remedy, as he might do in a supposable case, where another had put himself at a disadvantage on the faith of a contract with him to commit a crime.

Whether in this commonwealth a contract entered into by a corporation *ultra vires*, and partly performed, will ever be enforced on equitable grounds, we need not now decide. See *McCluer v. Manchester & Lawrence Railroad*, 13 Gray 124; *National Pemberton Bank v. Porter*, 125 Mass. 333; *Attleborough National Bank v. Rogers*, 125 Mass. 339; *Atlas National Bank v. Savery*, 127 Mass. 75, 77; *Slater Woollen Co. v. Lamb*, 143 Mass. 420; *Prescott National Bank v. Butler*, 157 Mass. 548; *National Bank v. Matthews*, 98 U. S. 621; *National Bank v. Whitney*, 103 U. S. 99; *Parish v. Wheeler*, 22 N. Y. 494; *Oil Creek & Allegheny River Railroad v. Pennsylvania Transportation Co.*, 83 Pa. St. 160; *Bradley v. Ballard*, 55 Ill. 413. In the present case we think it makes no difference that the defendant was not a manufacturing or trading corporation, but was chartered for educational purposes only. It could acquire and hold property, make contracts, and do anything else incidental to the maintenance of the school. Doubtless some of its officers or agents thought it would be an advantage to its students and managers to have a public ferry at the place where the plaintiff was injured. Its maintenance of such a ferry was *ultra vires*, but its acts in that respect were not different in kind from the ordinary acts of corporations in excess of the powers given them by their charter. We are of opinion, therefore, that if the defendant while running the ferry-boat accepted the plaintiff as a passenger to be transported for hire, and undertook to carry him across the river, he was in the boat as a



licensee, it owed him the duty to use proper care to carry him safely, and, whether an action could be maintained for a breach of the contract or not, it is liable to the plaintiff in an action of tort for neglect of that duty.

The other question in the case is whether there was evidence that the corporation operated the ferry. Under its by-laws the management of the corporation is vested in a board of trustees. It does not appear that any vote was ever taken in regard to the ferry, and it was not shown that any officer of the corporation took out the license which was granted to the defendant by the county commissioners, under Pub. Sts., ch. 55, § 1, to keep the ferry; but the records of the county commissioners show that such a license was granted, and that a bond with sureties was given to the county of Franklin, with the condition properly to perform the duty of a ferryman, executed in behalf of the defendant by one who was designated as superintendent, and witnessed by the defendant's cashier and paymaster. It further appeared that the title to the property used at the ferry was taken by Ambert G. Moody, one of the trustees of the defendant, who was then a student in Amherst College, and that he paid for it only a nominal sum above the mortgage existing upon it, and that he and the defendant's superintendent, who had charge of its farm, employed one Deane to operate the ferry, who was paid by the month, and who turned over the balance of the receipts of the ferry above his wages to the defendant's cashier and paymaster. For the month of April, Deane was paid for his services by the defendant's paymaster out of the defendant's funds. In June, 1890, a new ferry-boat was constructed under an arrangement with Ambert G. Moody and Dwight L. Moody, both of whom were trustees of the corporation, and was paid for by the paymaster out of the funds of the corporation. For six months, and until there was a change in the management of the ferry, the defendant's cashier and paymaster sent to the treasurer, who lived in New York, monthly accounts, showing monthly receipts and expenses on account of the ferry. Accompanying the first of these accounts was a statement that the school was running the ferry and paying the bills. The treasurer was himself a trustee of the corporation. He subsequently rendered his official report to the corporation, which was audited by another of the trustees, who did not examine the items in person, but caused the examination to be made by a man in his employment. This report was accepted by the trustees and placed on file. The items of receipts and expenditures were entered on the books of the treasurer in an account under the title "Ferry." The treasurer's report was not put in evidence, and was not produced, although the defendant was notified to produce it.

There is no evidence of original authority from the defendant to anybody to operate the ferry on its account, but the evidence is plenary that persons connected with the management of its business assumed so to operate it. The important question is whether there was evidence that the corporation ratified the acts of these persons. We are of opinion that there was evidence from which the jury might



have found such ratification. It is not necessary that the ratification should be by a formal vote. It is enough if the corporation, acting through its managing officers, knowing that the business had been done by those who assumed to act as its agents in doing it, and that the income of the business had been received and the expenses of it paid by its treasurer in his official capacity, and that the balance of the receipts above the expenditures was in its treasury, adopted the action of its treasurer, and elected to keep the money. It was a fair inference of fact, especially when the corporation failed to produce the treasurer's report after notice to produce it, that the report contained a true statement of the accounts which related to the ferry, and that it was accepted with full knowledge on the part of the trustees of what it contained. Whether there was a ratification by the corporation was a question of fact for the jury on all the evidence.

If there was such a ratification, it carried with it the consequences which would have followed an original authority. In *Dempsey v. Chambers*, 154 Mass. 330, it was held, after much consideration, that ratification of an unauthorized act would make the principal liable in an action of tort for an injury resulting from negligence of the agent in doing the act.

We are of opinion that the case should have been submitted to the jury.

Exceptions sustained.

*Note. Negligence:* 1839, *Lowell v. B. & L. R. Co.*, 23 Pick. (Mass.) 24, 34 Am. Dec. 33; 1850, *Walling v. Mayor, etc., of Shreveport*, 5 La. Ann. 660, 52 Am. Dec. 608; 1857, *Hopkins v. A. & St. L. R. Co.*, 36 N. H. 9, 72 Am. Dec. 287; 1865, *Illinois Central R. v. Read*, 37 Ill. 484, 87 Am. Dec. 260; 1865, *Donaldson v. Mississippi R. Co.*, 18 Iowa 280, 87 Am. Dec. 391; 1869, *Helsdorf v. City of St. Louis*, 45 Mo. 94, 100 Am. Dec. 352; 1873, *Flike v. Railroad Co.*, 53 N. Y. 549, 13 Am. Rep. 545; 1873, *Macon & Augusta R. Co. v. Mayes*, 49 Ga. 355, 15 Am. Rep. 678; 1877, *City of Petersburg v. Applegarth*, 28 Gratt. (Va.) 321; 1880, *Smith v. Oxford Iron Co.*, 42 N. J. L. (13 Vroom) 467, 36 Am. Rep. 535; 1883, *Singleton v. S. W. Railroad*, 70 Ga. 464, 48 Am. Rep. 574; 1884, *Denver S. P. & P. R. Co. v. Conway*, 8 Colo. 1, 54 Am. Rep. 537; 1887, *Lancaster Ave. I. Co. v. Rhoads*, 116 Pa. St. 377, 2 Am. St. 608; 1888, *Dunn v. Agricultural Soc.*, 46 Ohio St. 93, 15 Am. St. Rep. 556; 1890, *Elmore v. Drainage Commrs.*, 135 Ill. 269, 25 Am. St. Rep. 363; 1890, *American Dist. Tel. Co. v. Walker*, 72 Md. 454, 20 Am. St. Rep. 479; 1894, *Mattise v. Manufacturing Co.*, 46 La. Ann. 1535, 16 So. Rep. 400.

*Ultra vires torts:* See note, *supra*, p. 1232.

## Sec. 398. (10) Charitable corporations.

### FIRE INSURANCE PATROL v. JULIA F. BOYD.<sup>1</sup>

1888. IN THE SUPREME COURT OF PENNSYLVANIA. 120 Pa. St. Rep. 624-650, 6 Am. St. Rep. 745.

[Action by the widow and minor son of C. S. Boyd, against the Fire Insurance Patrol, a corporation, and H. and K., its employes;

<sup>1</sup> Statement abridged. Arguments and part of opinion omitted.

for damages for negligently killing Boyd. The company, after a fire, sent H. and K. to remove tarpaulin from the fourth story of the building where the fire had been. Instead of lowering them by a convenient hoist near by, they concluded to throw them out of the window on to the street below. K. went down to the sidewalk to warn persons of the danger, and H. threw out the bundles of tarpaulin, one of which struck Boyd, who came out of his store near by and started across the street. He was injured so that he died shortly after. He was warned by K., but not soon enough. There was a verdict for plaintiff for \$39,000, all of which over \$25,000 was remitted, and judgment for that sum rendered. The company brought a writ of error.]

PAXSON, J. As disclosed by the charter, "the object of the corporation was to protect and save life and property in or contiguous to burning buildings, and to remove and take charge of such property or any part thereof, when necessary." As disclosed by the evidence, it appears to be a corporation without capital stock or moneyed capital; that it is supported by voluntary contributions, derived from different fire insurance companies; that its object and business is to save life and property in or contiguous to burning buildings; that in saving and protecting such property no difference is made between property insured and property which is not insured; that no profits or dividends are made and divided among the corporators. \* \* \*

Is the Insurance Patrol a public charitable institution? The learned court below held that it was not, upon the ground that the main object of the institution was to benefit the insurance companies, who were the chief contributors to its funds. In other words, the learned judge tested the nature and character of the institution by the motives of its contributors. \* \* \*

In *Morice v. Bishop of Durham*, 9 Ves. 405, it was said by Sir William Grant that those purposes are considered charitable which are enumerated in the statute of 43d Elizabeth, or which by analogy are deemed within its spirit and intendment. It is true that this statute of Elizabeth is not in force in Pennsylvania, but its principles are a part of the common law: *Cresson's Appeal*, 30 Pa. St. 450. In *British Museum v. White*, 2 Sim. & S. 596, a charitable gift was defined to be, "Every gift for a public purpose, whether local or general, although not a charitable use within the common and narrow sense of those words." In *Jones v. Williams*, Ambler 651, Lord Camden gives this practical definition, viz.: "A gift to a general public use which extends to the poor as well as to the rich." This definition has been repeatedly approved by this and other courts: See *Wright v. Linn*, 9 Pa. St. 433; *Coggeshall v. Pelton*, 7 Johns. Ch. 294; *Milford v. Reynolds*, 1 Phil. Ch. R. 191; *Perrin v. Carey*, 24 How. 506; *Jackson v. Phillips*, 14 Allen 556.

These brief citations from the English authorities are deemed sufficient. I now turn to our own and other states. In *Cresson's Appeal*, 30 Pa. St. 437, this court, after citing with approval *Jones v. Williams*, *supra*, said: "In order to ascertain what are charitable

uses, the English courts have generally resorted to the preamble of the act of parliament, 43 Elizabeth. That enumerates twenty-one, and among them are found the following: Repairs of bridges; repairs of ports and havens; repairs of causeways; repairs of sea-banks; repairs of highways; fitting out soldiers; other taxes. And beyond the enumeration contained in that act, many other gifts have been recognized as common law gifts to charitable uses, for example: for cleansing the streets, maintenance of houses of correction; for the true labor and exercise of husbandry, for public benefit. These cases and many others are collected in *Magill v. Brown*, Brightly 347. It is true the statute of Elizabeth is not in force as a statute in Pennsylvania, but, as before stated, its principles are part of our common law. The case of *Magill v. Brown* was a Pennsylvania case, and there it was held that a bequest for a fire engine and hose was a gift for a charitable use." In *Jackson v. Phillips*, 14 Allen 556, a charity was defined by Justice Gray as follows: "A charity, in legal sense, may be more fully defined as a gift to be applied consistently with existing laws for the benefit of an indefinite number of persons, either by bringing their minds or hearts under the influence of education or religion, by relieving their bodies from disease, suffering or constraint, by assisting them to establish themselves in life, or by erecting or maintaining public buildings or works, or otherwise lessening the burdens of government." This definition has been cited approvingly, not only by text writers, but by other courts.

In *Miller v. Porter*, 53 Pa. St. 292, there was a bequest by Porter to a university which was to bear his name, and this court said: "You say it (The Porter University) was not founded to promote religion or religious education, but to immortalize the founder, and therefore it was not a charity. If the premises be granted, the conclusion does not follow, because though it has no stamp of religion, and the selfishness of motive may take away from it the high and abstract quality of a Christian charity, yet it was to be a seat of learning—a university—a center from which the rays of educated intelligence were to radiate in all directions; and, if to found a school-house at the cross-roads of a township be a legal charity, though the selfish motive be apparent, much more to found such a university is a legal charity; and, if a charity within the legal sense of that word, then it is as much within the purview of the statute as a bequest to the West Town School, and *Price v. Maxwell* rules the case." Following in this line of thought is *Manners v. The Library Co.*, 93 Pa. St. 165, where it was held in the case of a public charity that the intent of the testator will not be defeated because a secondary intent may be illegal, for if it be unlawful it will be disregarded. In *Appeal of The Humane Fire Company*, 88 Pa. St. 389, it was distinctly ruled by this court that the association was a public charity. That company was one of the members of the old volunteer fire department of the city of Philadelphia; was organized for the purpose of extinguishing fires, and was supported just as the Fire Insurance Patrol is supported, by voluntary

contributions. It is true, many of its contributions came from private citizens, but I am unable to see any distinction between contributions to a fire company or insurance patrol, made by individuals and those made by corporations. In both cases a corresponding benefit is expected. It would be idle to say that the insurance companies do not expect to diminish their losses by their support of the Insurance Patrol. But has the private citizen who contributes to a fire company any higher motive? Does he pay his money out of love to God and love to man, or does he pay it to protect his property?

It will be noticed that in no one of the cases cited is the motive of the donor made a test of a charity. While it is true that a gift within the definition of Mr. Binney is a good charitable use, and in a moral sense perhaps the best, it has never been held that said definition is a test of a charity. On the contrary, this court held in *Martin v. McCord*, 5 Watts 493, that the accession to a charity need not be by gift, but may be by contract; and that the accession to the charitable use from one who gave ground for a school-house, if the neighbors would go on and build a decent house on it for the benefit of the neighborhood, and for the benefit of his grandson John, whom he wished to send to school, was good; and Sergeant, J., said "not as a gift, but as a purchase for a valuable consideration," and the neighbors were the trustees for a charitable use. And in *Miller v. Porter*, *supra*, we have already seen that this court expressly repudiated the idea that the selfish motive affected the legal nature of the gift or use, and held that the object of the bequest only, and not the motive, governed its legal effect. The true test of a legal public charity is the object sought to be attained; the purpose to which the money is to be applied, not the motive of the donor.

Our conclusion is that the Fire Insurance Patrol of Philadelphia is a public charitable institution; that in the performance of its duties it is acting in aid and in ease of the municipal government in the preservation of life and property at fires. It remains to inquire whether the doctrine of *respondeat superior* applies to it. Upon this point we are free from doubt. It has been held in this state that the duty of extinguishing fires and saving property therefrom is a public duty, and the agent to whom such authority is delegated is a public agent and not liable for the negligence of its employes. This doctrine was affirmed by this court in *Knight v. City of Philadelphia*, 15 W. N. 307, where it was said: "We think the court did not commit any error in entering judgment for the defendant upon the demurrer. The members of the fire department are not such servants of the municipal corporation as to make it liable for their acts or negligence. Their duties are of a public character and for a high order of public benefit. The fact that this act of assembly did not make it obligatory on the city to organize a fire department, does not change the legal liability of the municipality for the conduct of the members of the organization. The same reason which exempts the city from liability for the acts of its policemen, applies with equal force to the acts of the firemen." And it would seem from this and other cases to make

no difference, as respects the legal liability, whether the organization performing such public service is a volunteer or not. *Jewett v. New Haven*, 38 Conn. 379; *Russell v. Men of Devon*, 2 T. R. 672; *Feoffees of Heriot's Hospital v. Ross*, 12 C. & F. 506; *Riddle v. Proprietors*, 7 Mass. 187; *McDonald v. Hospital*, 120 Mass. 432; *Boyd v. Insurance Patrol*, 113 Pa. St. 269. But I will not pursue this subject further, as there is another and higher ground upon which our decision may be placed.

The Insurance Patrol is a public charity; it has no property or funds which have not been contributed for the purposes of charity, and it would be against all law and all equity to take those trust funds, so contributed for a special, charitable purpose, to compensate injuries inflicted or occasioned by the negligence of the agents or servants of the patrol. It would be carrying the doctrine of *respondere superior* to an unreasonable and dangerous length. That doctrine is at best—as I once before observed—a hard rule. I trust and believe it will never be extended to the sweeping away of public charities; to the misapplication of funds, specially contributed for a public charitable purpose, to objects not contemplated by the donors. I think it may be safely assumed that private trustees, having the control of money contributed for a specific charity, could not, in case of a tort committed by one of their members, apply the funds in their hands to the payment of a judgment recovered therefor. A public charity, whether incorporated or not, is but a trustee, and is bound to apply its funds in furtherance of the charity and not otherwise. This doctrine is hoary with antiquity, and prevails alike in this country and in England, where it originated as early as the reign of Edward V, and it was announced in the Year Book of that period. In the *Feoffees of Heriot's Hospital v. Ross*, 12 C. & F. 506, a person eligible for admission to the hospital brought an action for damages against the trustees for the wrongful refusal on their part to admit him. The case was appealed to the House of Lords, when it was unanimously held that it could not be maintained.

Lord Cottenham said: "It is obvious that it would be a direct violation, in all cases, of the purpose of a trust if this could be done, for there is not any person who ever created a trust that provided for payment out of it of damages to be recovered from those who had the management of the fund. No such provision has been made here. There is a trust, and there are persons intended to manage it for the benefit of those who are to be the objects of the charity. To give damages out of a trust fund would not be to apply it to those objects which the author of the fund had in view, but would be to divert it to a completely different purpose."

Lord Brougham said: "The charge is that the governors of the hospital have illegally and improperly done the act in question, and, therefore, because the trustees have violated the statute, therefore—what? Not that they shall themselves pay the damages, but that the trust fund which they administer shall be made answerable for their



misconduct. The finding on this point is wrong, and the decree of the court below must be reversed."

Lord Campbell: "It seems to have been thought that if charity trustees have been guilty of a breach of trust, the persons damnified thereby have a right to be indemnified out of the trust funds. That is contrary to all reason, justice and common sense. Such a perversion of the intention of the donor would lead to most inconvenient consequences. The trustees would in that case be indemnified against the consequences of their own misconduct, and the real object of the charity would be defeated. Damages are to be paid from the pocket of the wrong-doer, not from a trust fund. A doctrine so strange, as the court below has laid down in the present case, ought to have been supported by the highest authority. There is not any authority, not a single shred here to support it. No foreign or constitutional writer can be referred to for such a purpose."

I have quoted at some length from the opinions of these great jurists because they express in vigorous and clear language the law upon this subject. I have not space to discuss the long line of cases in England and this country in which the above principle is sustained. It is sufficient to refer to a few of them by name: *Riddle v. Proprietors of the Locks*, 7 Mass. 187; *McDonald v. Massachusetts General Hospital*, 120 Mass. 432; *Sherbourne v. Yuba Co.*, 21 Cal. 113; *Brown v. Inhabitants of Vinalhaven*, 65 Maine 402; *Mitchell v. City of Rockland*, 52 Maine 118; *City of Richmond v. Long*, 17 Grattan 375; *Ogg v. City of Lansing*, 35 Iowa 495; *Murtaugh v. City of St. Louis*, 44 Mo. 479; *Patterson v. Penn. Reform School*, 92 Pa. St. 229; *Maximillian v. Mayor*, 62 N. Y. 160.

I am glad to be able to say that no state in this country, or in the world, has upheld the sacredness of trusts with a firmer hand than the state of Pennsylvania. Not only is a trustee for a public or private use not permitted to misapply the trust funds committed to his care, but if he convert them to his own use the law punishes him as a thief. How much better than a thief would be the law itself were it to apply the trust's funds, contributed for a charitable object, to pay for injuries resulting from the torts or negligence of the trustee? The latter is legally responsible for his own wrongful acts. I understand a judgment has been recovered against the individual whose negligence occasioned the injury in this case. If we apply the money of the Insurance Patrol to the payment of this judgment, or of the same cause of action, what is it but a misapplication of the trust fund; as much so as if the trustees had used it in payment of their personal liabilities? It would be an anomaly to send a trustee to the penitentiary for squandering trust funds in private speculations, and yet permit him to do practically the same thing by making it liable for his torts. If the principle contended for here were to receive any countenance at the hands of this court, it would be the most damaging blow at the integrity of trusts which has been delivered in Pennsylvania. We are not prepared to take this step.

We are not unmindful of the fact that it was contended for the de-



fendant in error that the case of *Feoffees of Heriot's Hospital v. Ross* is in conflict with *Mersey Docks v. Gibbs*, L. R. 1 E. & I. App. Cas. (1 H. L.) 93, and *Parnaby v. Lancaster Canal Co.*, 11 Ad. & E. 223. I am unable to see any such conflict. The two corporations last named were evidently trading corporations and in no proper sense public charities. In regard to the docks, it was said by Blackburn, J., at page 465: "There are several cases relating to charities which were mentioned at your lordship's bar, but were not much pressed, nor, as it seems to us, need they be considered now; for whatever may be the law as to the exemption of property occupied for charitable purposes, it is clear that the docks in question can come within no such exemption."

I will not consume time by discussing the case of *Glavin v. Rhode Island Hospital*, 12 R. I. 411, which, to some extent, sustains the opposite view of this question. There a hospital patient, paying eight dollars per week for his board and medical attendance, was allowed to recover a verdict against the hospital for unskillful treatment, and it was held that the general trust funds of a charitable corporation are liable to satisfy a judgment in tort recovered against it for the negligence of its officers or agents. It is at least doubtful whether under its facts the case applies, and if it does, we would not be disposed to follow it in the face of the overwhelming weight of authority the other way, and of the sound reasoning by which it is supported.

The foregoing is little more than a reassertion of the views of this court as heretofore expressed in this case by our brother Clark: See 113 Pa. St. 269. Many of the authorities I have referred to are there cited by him. We are now more fully informed as to the facts of the case, and can apply to them the law as indicated in the former opinion.

We are all of opinion that the Insurance Patrol is not liable in this action, and the judgment against it is therefore

Reversed.

*Note. Liability of charitable corporations for torts.* Such corporations are generally held not liable, on the ground that their funds are trust funds, and the persons who actually commit the tortious act should be held liable. Educational corporations, charging tuition, Christian associations and churches are not within the rule of exemption: 1869, *Murtaugh v. City of St. Louis*, 44 Mo. 479 (city not liable for injury in its city hospital); 1876, *McDonald v. Mass. General Hospital*, 120 Mass. 432, 21 Am. Rep. 529 (hospital not liable); 1885, *Perry v. House of Refuge*, 63 Md. 20, 52 Am. Rep. 495 (house of refuge not liable); 1885, *Benton v. Trustees City Hospital*, 140 Mass. 13, 54 Am. Rep. 436 (hospital not liable); 1891, *Van Tassell v. Manhattan Eye and Ear Hospital*, 60 Hun (N. Y.) 585 (not liable); 1891, *Harris v. Woman's Hospital*, 27 Abb. N. C. 37 (not liable); 1893, *Haas v. Missionary Society*, 6 Misc. (N. Y.) 281 (religious corporation not liable); 1894, *Downes v. Harper Hospital*, 101 Mich. 555, 45 Am. St. Rep. 427, 25 L. R. A. 602, 60 N. W. Rep. 42 (not liable); 1894, *Williams v. Louisville Indus. School*, 95 Ky. 251, 44 Am. St. Rep. 243, 23 L. R. A. 200, 24 S. W. Rep. 1065 (not liable); 1895, *Joel v. Woman's Hospital*, 89 Hun 73 (not liable); 1895, *Richardson v. Carbon Hill Co.*, 10 Wash. 648, 20 L. R. A. 338, 39 Pac. Rep. 95 (hospital kept by mining company without profit not liable); 1895, *Hearns v. Waterbury Hospital*, 66 Conn. 98, 33 Atl. Rep. 595 (public hospital not liable); 1895, *Eighmy v. Union Pacific R.*

Co., 93 Iowa 538, 27 L. R. A. 296, 61 N. W. Rep. 1056 (free railroad hospital not liable); 1895, *Pierce v. Union Pacific R. Co.*, 66 Fed. Rep. 44, 32 U. S. App. 48, 13 C. C. A. 323 (free railroad hospital not liable); 1899, *Powers v. Mass. Homeopathic Hospital*, 101 Fed. Rep. 896 (not liable); 1900, *Connor v. Sisters of Poor*, 10 Ohio St. & C. P. Dec. 86 (not liable); 1903, *Overholser v. National Soldiers' Home*, 68 O. S. 236, 62 L. R. A. 936.

*Contra*: 1879, *Glavin v. Rhode Island Hospital*, 12 R. I. 411, 34 Am. Rep. 675 (public charitable hospital is liable).

A cemetery association (1888, *Donnelly v. Boston Catholic Cemetery Association*, 146 Mass. 163); a fire company (1890, *Newcomb v. Boston Protective Dept.*, 151 Mass. 215, 6 L. R. A. 778), and a Young Men's Christian Association (1896, *Chapin v. Holyoke Y. M. C. A.*, 165 Mass. 280, 42 N. E. Rep. 1130), are *private* corporations and are liable for their torts.

On the general doctrine of non-liability in public functions see note 30 Am. St. Rep. 376-413.

## Sec. 399. (11) Exemplary damages.

### MAISENBACHER v. SOCIETY CONCORDIA.<sup>1</sup>

1899. IN THE SUPREME COURT OF CONNECTICUT. 71 Conn. Rep. 369-380, 71 Am. St. Rep. 213-219.

(Action for damages for assault and battery.)

HALL, J. The complaint alleges in substance that the plaintiff, having contracted with and paid the defendant for the privilege of dancing at a certain ball, was, by the forcible acts of the defendant's agents, prevented from exercising her said right, and was thereby caused pain and damage. \* \* \*

Apparently, no question was made at the trial but that under the pleadings the plaintiff, upon proof that the defendant's agent forcibly prevented her from dancing, became entitled to a verdict for a sum sufficient to indemnify her for the actual injuries she sustained, and which were the direct and natural consequences of the wrongful act complained of. The complaint alleges that in consequence of the assault the plaintiff was deprived of the privileges of the ball, that she suffered physical and mental pain and anguish, and lost her earnings in the trade at which she had been employed. The court instructed the jury that in determining the amount of compensatory damages to be awarded the plaintiff, they might take into consideration the indignity she had suffered by an assault in so public a place, the mental as well as her physical suffering which it caused her, and such loss as had been proved she had thereby sustained from inability to work at her trade.

"All the attending acts and circumstances which accompany and give character to the assault may be given in evidence to enhance the damages." *Brzezinski v. Tierney*, 60 Conn. 55, 62. Mental as well as physical suffering, when properly alleged, may be proved as an element of actual damage, and as naturally and directly resulting from an assault of the character described in the complaint. *Gibney v. Lewis*, 68 Conn. 392, 396; *Seger v. Barkhamsted*, 22 Conn. 290,

<sup>1</sup> Part of opinion omitted.

298; *Masters v. Warren*, 27 Conn. 293, 299. The defendant has no cause to complain of the charge of the court with reference to the elements which go to make up compensatory damages.

The complaint alleges that the defendant's agent, in committing the assault, "addressed the plaintiff in loud, threatening and insulting language," and that the assault upon the plaintiff was "committed in a gross, wanton and reckless manner, and with intent to" injure the plaintiff.

The defendant, in effect, requested the court to charge the jury that the defendant society could not, upon the proof presented, be held liable in exemplary damages. The court did not comply with this request, but instructed the jury that in case they found that a battery had been inflicted upon the plaintiff by the defendant's agent, "wantonly, maliciously, or in wanton disregard of the plaintiff's rights," they might add to that sum which they should find sufficient to compensate the plaintiff for her injuries, "a sum as exemplary or punitive damages," and might award her as punitive damages such sum as the jury, from their "knowledge of the course of business in the courts of law in this state," should find "to be her expense in conducting this trial," less the taxable costs which she would recover.

The jury returned a verdict for the plaintiff for three hundred dollars. We have not the evidence in the case before us, but from the finding of facts and from the charge of the court, stating the claims of the parties as to the character and extent of the plaintiff's injuries, we think the jury may, under such instruction, have included in their verdict, as an element of damages, the expenses incurred by the plaintiff in conducting her trial, less the taxable costs; and unless this is a case in which such expenses could lawfully be recovered, the charge of the court was incorrect and a new trial should be granted.

That a plaintiff may, in an action for an assault and battery and in certain other actions of tort, recover certain damages which are not compensatory within the technical and legal meaning of that word, but which are awarded with the view of punishing the defendant for his wrongful act, has been settled in this state, beyond question, by a large number of decisions extending from *Linsley v. Bushnell*, 15 Conn. 225, 38 Am. Dec. 79, to *Gibney v. Lewis*, 68 Conn. 392.

The cases in which punitive damages may be awarded are only those actions of tort "founded on the malicious or wanton misconduct of the defendant," or upon "such culpable neglect of the defendant" as is "tantamount to malicious or wanton misconduct." *St. Peter's Church v. Beach*, 26 Conn. 355; *Welch v. Durand*, 36 Conn. 182, 4 Am. Rep. 55; *Burr v. Plymouth*, 48 Conn. 460. And private corporations, as well as individuals, may for their own acts become liable in punitive damages: *Sedgwick on Damages*, 8th ed., § 379; *Merrills v. Tariff Mfg Co.*, 10 Conn. 384, 27 Am. Dec. 682; *Murphy v. New York, etc., R. Co.*, 29 Conn. 496.

The expenses of litigation are not an element of the damages termed in law actual or compensatory damages; "they are not the natural

and proximate consequence of the wrongful act," and they can only be considered by the jury in those cases in which exemplary damages may be awarded. *St. Peter's Church v. Beach*, 26 Conn. 355; *Platt v. Brown*, 30 Conn. 336; *Mason v. Hawes*, 52 Conn. 12, 52 Am. Rep. 552; *Gibney v. Lewis*, 68 Conn. 392. Such expenses in excess of taxable costs, in cases in which they may be considered, limit the amount of punitive damages which can be awarded. *Wilson v. Granby*, 47 Conn. 59, 36 Am. Rep. 51; *Burr v. Plymouth*, 48 Conn. 460. In cases where they may be considered, it is not usual to prove the expenses of litigation actually incurred, but the court may admit relevant evidence for that purpose. *Bennett v. Gibbons*, 55 Conn. 450.

The case before us, as shown by the record, is not one in which the defendant society could be held liable in punitive damages. The defendant is a corporation. The alleged assault was committed by a floor manager "appointed by the defendant to have the regulation and charge of the dancing" at a ball given by the defendant. The assault, which the court instructed the jury would, if found to have been committed and to have been inflicted wantonly and maliciously, entitle the plaintiff to exemplary damages, was the putting of his hand by one of the floor managers upon the plaintiff's shoulder, "rudely, insolently, or angrily," and while she was upon the ballroom floor, "at the same time telling her that she could not dance there, and that she was not a fit person to be there." If these facts are sufficient to show that the act of the agent was malicious or wanton, they do not prove that the principal in any way participated in such malicious or wanton misconduct. As its agent was acting within the scope of his employment, the law compels the defendant to compensate the plaintiff for the injuries she has sustained from the wrongful acts of the agent, but it does not punish the defendant for the malicious purpose or intent which prompted the agent's conduct.

To render the principal liable in exemplary damages for the acts of his agent in the course of his employment, but done with such malicious intent, some misconduct of the former beyond that which the law implies from the mere relation of principal and agent must be shown. It is not claimed that the defendant society directed the floor manager to remove the plaintiff, or to act toward any person in the manner in which it is alleged he did, or that the defendant has since adopted or approved of his action.

In *Cleghorn v. New York, etc., R. R. Co.*, 56 N. Y. 44, 47, 15 Am. Rep. 375, Chief Justice Church, in delivering the opinion of the court, says: "For injuries by the negligence of a servant while engaged in the business of the master, within the scope of his employment, the latter is liable for compensatory damages; but for such negligence, however gross or culpable, he is not liable to be punished in punitive damages unless he is also chargeable with gross misconduct."

In the case of *Lake Shore, etc., Ry. Co. v. Prentice*, 147 U. S. 101, 107, in which this question is very fully discussed and the de-

cisions in both the federal and state courts upon this subject reviewed, Mr. Justice Gray, speaking for the court, laid down the rule as deducible from the authorities, that "guilty intention upon the part of the defendant is required in order to charge him with exemplary or punitive damages. \* \* \* Exemplary or punitive damages, being awarded, not by way of compensation to the sufferer, but by way of punishment of the offender, and as a warning to others, can only be awarded against one who has participated in the offense. A principal, therefore, though of course liable to make compensation for injuries done by his agent within the scope of his employment, can not be held liable for exemplary or punitive damages, merely by reason of wanton, oppressive or malicious intent upon the part of the agent."

In 1 Sedgwick on Damages, eighth edition, sections 378 and 380, the author, after citing very fully the conflicting authorities in different jurisdictions upon this question, says: "It is the better opinion that no recovery of exemplary damages can be had against a principal for the tort of an agent or servant, unless the defendant expressly authorized the act as it was performed, or approved it, or was grossly negligent in hiring the agent or servant."

In the case at bar, as it appears by the record before us, we think compensation for the injury suffered was the full measure of the defendant's responsibility, and that there was error in charging the jury that they might award the plaintiff as punitive damages the expenses of trial in excess of taxable costs, and in not charging upon the subject of punitive damages as requested by defendant.

Error and new trial granted.

In this opinion the other judges concurred.

*Note.* Corporations are liable for exemplary damages under the same circumstances as a master for the acts of the servant, and in this case the managing officers represent the corporation: 1858, Peoria Bridge Assn. v. Loomis, 20 Ill. 235, 71 Am. Dec. 263; 1868, Chicago v. Martin, 49 Ill. 241, 95 Am. Dec. 590; 1869, New Orleans, etc., R. Co. v. Statham, 42 Miss. 607, 97 Am. Dec. 478; 1869, Goddard v. Grand Trunk R. Co., 57 Maine 202, 2 Am. Rep. 39; 1869, Atlantic, etc., R. Co. v. Dunn, 19 Ohio St. 162, 2 Am. Rep. 382; 1873, Hanson v. European, etc., R. Co., 62 Maine 84, 16 Am. Rep. 404; 1884, Phil., etc., R. Co. v. Hoefflich, 62 Md. 300, 50 Am. Rep. 223; 1887, Internat'l, etc., R. Co. v. Telephone Co., 69 Texas 277, 5 Am. St. Rep. 45; 1890, Alabama, etc., R. Co. v. Hill, 90 Ala. 71, 24 Am. St. Rep. 764; 1892, Spellman v. Richmond, etc., R., 35 S. C. 475, 28 Am. St. Rep. 858; 1892, Samuels v. Richmond, etc., R., 35 S. C. 493, 28 Am. St. Rep. 883; 1893, L. S. & M. S. R. Co. v. Prentice, 147 U. S. 101; 1894, Childers v. San Jose, etc., Pub. Co., 105 Cal. 284, 45 Am. St. Rep. 40; 1894, Baltimore, etc., R. Co. v. Barger, 80 Md. 23, 45 Am. St. Rep. 319; 1896, Hoboken P. & Pub. Co. v. Kahn, 59 N. J. L. 218, 59 Am. St. Rep. 585; 1898, Mack v. South Bound R., 52 S. C. 323, 68 Am. St. Rep. 913; 1899, Washington G. L. Co. v. Lansden, 172 U. S. 534; 1899, Peterson v. W. U. Tel. Co., 75 Minn. 368, 74 Am. St. Rep. 502; 1901, Bingham v. Lipman, etc., Co., — Ore. —, 67 Pac. 98.

See, also, notes 59 Am. St. Rep. 589, *et seq.*, and 39 C. U. A., p. 9, *et seq.*

ARTICLE II. CRIMES.

Sec. 400. (1) Nonfeasance.

THE QUEEN v. THE BIRMINGHAM & GLOUCESTER RAILWAY CO.<sup>1</sup>

1842. IN THE QUEEN'S BENCH. 3 Adolphus & Ellis N.S. 223-233,  
43 Eng. C. L. 708.

[Indictment found at the spring assizes for the county of Worcester, 1840, against a corporation aggregate, the Birmingham and Gloucester Railway Company, for disobedience to an order of justices and an order of sessions confirming it, whereby the defendants, pursuant to certain provisions contained in the statute incorporating the company, were directed to make certain arches to connect lands which had been severed by the railway. The defendants not coming in to plead under the usual venire, some of the goods of the company were seized under a *distringas*.

Afterward the defendants appeared and demurred.]

PATTESON, J. Upon the argument it was not contended on the part of the company that an action of trespass might not be maintained against a corporation; for, notwithstanding some dicta to the contrary in the older cases, it may be taken for settled law, since the case of *Yarborough v. The Bank of England*, 16 East 6, in which the cases were reviewed, that both trover and trespass are maintainable; but it was said that an indictment will not lie against a corporation. Only one direct authority was cited for this position; and it is a dictum of Lord Holt in an anonymous case reported in 12 Mod. 559. The report itself is as follows: "Note: Per Holt, Chief Justice. A corporation is not indictable, but the particular members of it are." What the nature of the offense was to which the observation was intended to apply does not appear, and as a general proposition it is opposed to a number of cases, which show that a corporation may be indicted for breach of a duty imposed upon it by law, though not for a felony, or for crimes involving personal violence, as for riots or assaults: Hawk. P. C., b. 1, ch. 66, sec. 13, vol. 2, p. 58, 7th ed.

A corporation aggregate may be liable by prescription, and compelled to repair a highway or a bridge: Hawk. P. C., b. 1, ch. 76, sec. 8, ch. 77, sec. 2, vol. 2, pp. 156, 258; and in the case of *Rex v. The Mayor, etc., of Liverpool*, 3 East 86, the corporation was indicted by its corporate name for non-repair of a highway, and, upon argument in this court, the indictment was held to be defective; but no question was made as to the liability of a corporation to be indicted.

In the case of *Rex v. The Mayor, etc., of Stratford-upon-Avon*, 14 East 348, the corporation was indicted by its corporate name for a

<sup>1</sup> Statement abridged, arguments omitted.



## Sec. 402. (3) Libel.

STATE v. ATCHISON.<sup>1</sup>

1879. IN THE SUPREME COURT OF TENNESSEE. 3 Lea (Tenn.)  
Rep. 729, 31 Am. Rep. 663.

FREEMAN, J. This is an indictment for libel, quashed in the court below and appealed by the state. The indictment has two counts, the first against Atchison and Buck, the second against the Banner Publishing Company. The matter alleged is the same in both counts.

(After holding that the matter was libelous.)

It is next objected that the joinder of two different counts against two different parties is error, for which the indictment should have been quashed. In the case of the State v. Lea, there was one count against Polly Bailey for perjury, and a second against Lea for subornation of perjury. The court say: "We are unable to perceive why these parties were not properly joined in the same indictment, and charged in separate counts, though their offenses be distinct. They were of the same nature, admitted of the same plea and same judgment." 1 Cold. 177. So, in this case, the offense is precisely the same—the same plea is appropriate. It is true the corporation may not be imprisoned, but the fact that the same measure of punishment can not be inflicted in this way can not vitiate the indictment; the judgment is of the same character, that is, a fine and costs. That imprisonment might possibly be inflicted in one case and not in the other, can not in the least affect the validity of the indictment. The principal of such an objection is that joinder of different offenses might embarrass the parties in their defense. The fact that one could not be imprisoned after conviction, certainly can have no influence in the conduct of the trial on the question of guilty or not guilty.

We see no ground on which the judgment can be sustained, and reverse it, remanding the case for further proceedings.

*Note. Criminal liability of corporations:* See, 1701, Anonymous, 12 Mod. 559, holding corporation is not indictable; also, 1841, State v. Great Works, etc., Co., 20 Maine 41, 37 Am. Dec. 38; 1874, Androscoggin Water Co. v. Mill Co., 64 Maine 441.

But corporations are now generally held to be indictable, for those crimes that are punished by such penalties as can be applied to corporations, as in cases of

(a) Non-feasance in failing to make repairs: 1812, Mower v. Leicester, 9 Mass. 247; 1818, State v. Morris, etc., Co., 1 South. (N. J.) 165, 7 Am. Dec. 579; 1834, People v. Albany, etc., 11 Wend. 539; 1836, Susquehanna, etc., v. People, 15 Wend. 267; 1850, State v. Murfreesboro, 11 Humph. (Tenn.) 217; 1853, Commw. v. Central Bridge Co., 66 Mass. 242; 1855, Boston, etc., R. Co. v. State, 32 N. H. 215; 1857, Regina v. Manchester, 7 El. & B. 453; 1865, Queen v. Navigation, 6 Best. & S. 631; 1878, People v. N. Y., etc., R. Co., 74 N. Y. 302; 1887, Godwinsville, etc., Co., 49 N. J. L. 266.

*Compare*, 1841, State v. Great W. Mill Co., 20 Maine 41.

(b) *Misfeasance*, as creating a nuisance: 1852, State v. Morris, etc., R. Co.,

<sup>1</sup> Part of opinion omitted.

23 N. J. Law 360; 1854, Commw. v. New Bedford Bridge, 68 Mass. 339; 1855, Commw. v. Vermont, etc., R. Co., 70 Mass. 22; 1859, Louisville, etc., R. Co. v. State, 3 Head (Tenn.) 523, 75 Am. Dec. 778; 1865, Donaldson v. Mississippi, etc., R. Co., 18 Iowa 280, 87 Am. Dec. 391; 1869, Delaware Div. Co. v. Commw., 60 Pa. St. 367, 100 Am. Dec. 570; 1895, Commw. v. Lehigh Valley R., 165 Pa. St. 162; 1898, Paragon Paper Co. v. State, 19 Ind. App. 314.

(c) *Malfeasance*: 1876, Bremen v. Tracy, 2 Mo. App. 540 (libel); 1879, State v. B. & B. R. Co., 15 W. Va. 362, 36 Am. Rep. 803 (Sabbath-breaking); 1891, Commw. v. Pulaski Co., 92 Ky. 197; 1892, State v. Passaic Soc., 54 N. J. Law 260 (disorderly house); 1892, State v. Security Bank, 2 S. Dak. 538 (usury); 1898, Louisville Tobacco Co. v. Commw., 20 Ky. L. Rep. 1047, 48 S. W. Rep. 420; 1900, Standard Oil Co. v. Commw., 21 Ky. L. Rep. 1339, 55 S. W. Rep. 8.

### ARTICLE III. CONTEMPTS.

#### Sec. 403.

#### TELEGRAPH NEWSPAPER CO. v. COMMONWEALTH.<sup>1</sup>

1899. IN THE SUPREME JUDICIAL COURT OF MASSACHUSETTS.  
172 Mass. 294, 70 Am. St. Rep. 280, 44 L. R. A. 159, 52 N. E. Rep. 445.

The Telegram Newspaper Company and the Gazette Company were convicted of contempt in the publication of an article concerning a pending cause during its trial, and bring error. Affirmed.

FIELD, C. J. These are two writs of error, and, although the pleadings may possibly raise issues of fact as well as issues of law, the cases were entered, without objection on the part of any of the parties, upon the docket of the full court, and each case was heard upon the plea, "*In nullo est erratum.*" The Telegram Newspaper Company is a Massachusetts corporation, having its usual place of business in Worcester, and publishing there a daily newspaper. The Gazette Company is a corporation established under the laws of the state of Maine, having its usual place of business in Worcester, and publishing there a daily newspaper. \* \* \*

The petition of Silas H. Loring against the town of Holden at the time of the publication of the articles in the newspapers was on trial before the superior court then sitting at Worcester, and it was a petition for the assessment of damages suffered by the taking of land of the petitioner for the abolition of a grade crossing of the Fitchburg Railroad Company. The portion of the articles published which the court found was calculated to obstruct the course of justice in said court, and prevent a fair trial of said petition, was, after describing the petition of Loring against the town of Holden, the following: "The town offered Loring \$80 at the time of the taking, but he demanded \$250, and, not getting it, went to law," which appeared in the Worcester Daily Telegram; and "the town offered the plaintiff \$80, but he wanted \$250," which appeared in the Worcester Evening Gazette. \* \* \*

<sup>1</sup> Statement abridged.

The newspapers were published and circulated in Worcester, and it was not improbable at the time of publication that the articles would be read by some of the jurors before the trial of the petition was finished. \* \* \*

[The corporations were found guilty, and ordered to pay \$100 fine, and in default it was to be levied on their property.]

It is contended that a corporation can not be guilty of a criminal contempt of court, although it may be fined for what is called a "civil contempt." It is said that an intent can not be imputed to a corporation in criminal proceedings. It has been decided in this commonwealth that a corporation may be liable civilly for a libel or a malicious prosecution. *Fogg v. Railroad Co.*, 148 Mass. 513, 20 N. E. Rep. 109; *Reed v. Bank*, 130 Mass. 443. We think that a corporation may be liable criminally for certain offenses, of which a specific intent may be a necessary element. There is no more difficulty in imputing to a corporation a specific intent in criminal proceedings than in civil. A corporation can not be arrested and imprisoned in either civil or criminal proceedings; but its property may be taken, either as compensation for a private wrong or as punishment for a public wrong. In most of the states of this country corporations may be formed, under general laws, for the purpose of doing almost any kind of business, as easily as partnerships, and many of the newspapers are published by corporations. Although natural persons who publish or assist in publishing a libel in a newspaper owned by a corporation may be punished criminally by fine or imprisonment, or both, yet if the corporation can not be punished by a fine, it will escape all criminal liability. The authors of libels are often irresponsible persons, and the remedy by private action against corporations for the publishing of libelous statements is often inadequate. That a corporation may be indicted for a misfeasance as well as for a nonfeasance has been decided in this commonwealth. *Com. v. New Bedford Bridge*, 2 Gray 339. See *Reg. v. Great North of England Ry.*, 9 Adol. & E. (N. S.) 315, 326. A corporation may be indicted for a libel. *State v. Atchison*, 3 Lea 729, 31 Am. Rep. 663, and note; *Brennan v. Tracy*, 2 Mo. App. 543; *Pharmaceutical Soc. v. London & Provincial Supply Ass'n*, 5 App. Cas. 857, 869, 870; 2 Bish. New Cr. Law, § 935; *Newell Defam.* (2d ed.), 362, 363; *Odgers Sland.* (3d ed.), 436; 5 *Thomp. Corp.*, § 6418, *et seq.* The publication of an article in a newspaper which is printed and circulated in the place where a trial is had, pending the trial, and which concerns the cause on trial, and is calculated to prejudice the jury in the cause and prevent a fair trial, often has been held to be a criminal contempt of the court trying the cause. *O'Shea v. O'Shea*, 15 Prob. Div. 59; *Ex parte Green*, 7 Times Law Rep. 411; *Daw v. Eley*, L. R. 7 Eq. 55; *Ramsbotham v. Senior*, L. R. 8 Eq. 575; *People v. Wilson*, 64 Ill. 195; *In re Sturoc*, 48 N. H. 428; *In re Cheeseman*, 49 N. J. Law 137, 6 Atl. 513; *State v. Frew*, 24 W. Va. 416; *Oswald Contempt* (2d ed.), p. 58, *et seq.*; 7 Am. & Eng. Enc. Law (2d ed.), tit. "Contempt," p. 59. If a corporation pub-

lishes the article, we see no reason why it should not be held liable for a criminal contempt. 5 Thomp. Corp., § 6468, *et seq.*; 7 Am. & Eng. Enc. Law (2d ed.), p. 847, on Corporations and cases cited. There are no statutes in this commonwealth regulating the proceedings in the trial and punishment of contempt of court. "The summary power to commit and punish for contempt tending to obstruct or defeat the administration of justice is inherent in courts of chancery and other superior courts, as essential to the execution of their powers and to the maintenance of authority, and is part of the law of the land, within the meaning of Magna Charta and of the twelfth article of our declaration of rights." Cartwright's Case, 114 Mass. 230, 238; Tinsley v. Anderson, 171 U. S. 101, 18 Sup. Ct. 805. \* \* \*

The most important question is whether the publication of these articles under the circumstances stated could be adjudged a contempt. The articles published were not defamatory, either as regards the presiding justice of the court, or the jurors before whom the cause referred to was being tried, or the parties to the cause. In one case the court discharged the treasurer and manager of the newspaper, and in the other the editor and the publisher, on the ground that they were not shown to be directly responsible for the publications. It is probable (although this does not expressly appear in the papers before us) that the person or persons employed to report for each newspaper the proceedings of the court wrote the articles, and caused them to be published. The superior court has not found that there was an intent to influence the trial of the cause referred to on the part of anybody. The articles are objectionable only because they purport to state the amount of money which they said the town offered to pay the plaintiff, and the amount the plaintiff demanded, before the petition was brought. The law encourages attempts to settle or compromise disputes, without subjecting the parties to any liability, if the attempts fail, of having any concessions therein made to avoid litigation put in evidence against them in the subsequent litigation. Upton v. Railroad Co., 8 Cush. 600; Harrington v. Inhabitants of Lincoln, 4 Gray 563; Gay v. Bates, 99 Mass. 263; Draper v. Inhabitants of Hatfield, 124 Mass. 53. We are content to assume that the person or persons who wrote and caused the articles to be published did not know this rule of law, and acted without any intent to pervert the course of justice. As the only intent which can be imputed to the corporation is the intent of its officers or agents, the question is whether the publication of these articles without any intent to pervert the course of justice can be adjudged a contempt. In Hall Co. v. Lake, 58 Law J. Ch. 513, it is said that it must be shown that the articles were published with knowledge of the pending cause, and that appears in the present cases. In Cartwright's Case, *supra*, it is said by the court, "But the jurisdiction and power of the court do not depend upon the question whether the offense might or might not be punished by indictment."

"As regards the question whether a contempt has or has not been

committed, it does not depend upon the intention of the party, but upon the act he has done.' By Taney, J., in *Wartman v. Wartman*, Taney 362, 370, Fed. Cas. No. 17210." If a person talk with or send a statement to a juror about a cause, during the trial of it, in such a manner that it may cause prejudice or bias in the cause, although the intent with which the person acted may affect the amount of his punishment, he can not justify his conduct by showing that he had no evil intent, and knew no better.

It was not necessary that the superior court should find that the articles published actually had been read by some of the jurors while trying the cause to which the articles referred. They plainly had been read by the presiding justice during the trial, and it was likely that they had been read by some of the jurors. The intention of the publisher of a newspaper is that it should be bought and read by persons within the place where it circulates. Cases should be determined on the evidence presented in court. It is an inevitable perversion of the proper administration of justice to attempt to influence the judge or jury in the determination of a cause pending before them by statements outside of the court-room, and not in the presence of the parties, which may be false, and, even if they are true, are not in law admissible in evidence. We can not say that it appears that the superior court erred in adjudging that the publication of these articles, under the circumstances stated, was a contempt of that court; and it was for that court to determine whether it was necessary to institute proceedings for contempt in order to vindicate its authority to secure the due administration of justice in a cause pending before it. The publications contained statements of facts, evidence of which was not competent at the trial, and was not introduced at the trial; and they were so made that it was likely that the presiding justice and the jurors would read them during the trial, and the natural and probable effect of them was improperly to influence the court and jury in the determination of the cause.

The proper method of collecting a fine imposed upon a corporation is by levy of an execution, to be issued by the court. *Rex v. Woolf*, 2 Barn. & Ald. 609, 1 Chit. 583; *Huddleson v. Ruffin*, 6 Ohio St. 604, 1 Chit. Cr. Law (2d ed.) 811; 1 Bish. New Cr. Proc., § 1303, *et seq.*

Judgments affirmed.

*Note.* Accord: 1860, *People v. Albany & Vermont R. Co.*, 12 Abb. Pr. 171; 1889, *Sercomb v. Catlin*, 128 Ill. 556, 15 Am. St. Rep. 147.

*Contra*, *Davis v. Mayor*, 1 Duer 484.

## PART IV.

### SPECIAL RELATIONS ARISING FROM THE EXISTENCE OF A CORPORATION.

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#### DIVISION I. CORPORATE RELATIONS.

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#### TITLE I. THE CORPORATION AND THE STATE.

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#### CHAPTER 16.

#### GOVERNMENTAL CONTROL OF CORPORATIONS.

#### SUBDIVISION I. GENERAL DOCTRINES.

#### ARTICLE I. BY THE COURTS.

**Sec. 404.** 1. Generally, by permitting actions at law, and suits in equity by and against corporations, as in the case of individuals, for breaches of contracts or wrongs done.

See *supra*, §§ 322-6.

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**Sec. 405.** 2. Particularly, by *visitation*:

“Corporations being composed of individuals, subject to human frailties, are liable, as well as private persons, to deviate from the end of their institution. And for that reason, the law has provided proper persons to visit, inquire into, and correct all irregularities that arise in such corporations, either sole or aggregate, and whether ecclesiastical, civil or eleemosynary.”

“With respect to all *ecclesiastical* corporations, the ordinary is their visitor, so constituted by the canon law, and from thence derived to us. \* \* \*



“With respect to all *lay* corporations, the founder, his heirs or assigns, are the visitors, whether the foundation be civil or eleemosynary. \* \* \* The founder of all corporations, in the strictest and original sense, is the king alone, for he only can incorporate a society, and in *civil* incorporations, such as mayor or commonalty, etc., where there are no possessions or endowments given to the body, there is no other founder but the king: but in *eleemosynary* foundations, such as colleges and hospitals, where there is an endowment of lands, the law distinguishes, and makes two species of foundation: the one *fundatio incipiens*, or the incorporation, in which sense the king is the general founder of all colleges and hospitals; the other *fundatio perficiens*, or the dotation of it, in which sense the first gift of the revenues is the foundation, and he who gives them is in law the founder. \* \* \* And, in general, the *king* being the sole founder of all *civil* corporations, and the *endower* the perficient founder of all *eleemosynary* ones, the *right of visitation* of the former results, according to the rule laid down, to the king; and of the latter to the patron or endower.”

“The king being thus constituted by law visitor of all civil corporations, the law has also appointed the place wherein he shall exercise this jurisdiction, which is the court of king’s bench; where, and where only, all misbehaviors of this kind of corporations are inquired into and redressed, and all their controversies decided. \* \* \*”

“As to eleemosynary corporations, by the dotation the founder and his heirs are of common right the legal visitors to see that such property is rightly employed, as might otherwise have descended to the visitor himself, but, if the founder has appointed and assigned any other person to be visitor, then his assignee so appointed is invested with all the founder’s power, in exclusion of his heir. \* \* \*”  
1 Bl. Comm., pp. 480-2.

“To render the charter or constitutions, ordinances and by-laws of corporations of perfect obligation, and generally to maintain their peace and good government, these bodies are subject to *visitation*; or in other words, to the inspection and control of tribunals recognized by the laws of the land. Civil corporations are visited by the government itself, through the medium of the courts of justice; but the internal affairs of ecclesiastical and eleemosynary corporations are, in general, inspected and controlled by a private visitor.” Angell & Ames Corp., § 684. See *infra*, § 436.

#### ARTICLE II. BY LEGISLATIVE BODIES.

**Sec. 406.** In the United States, certain powers of control over corporations are either inherent in congress or the state legislatures, or result to them from express or implied constitutional provisions, or by virtue of powers reserved to them in the creation of corporations, but subject generally to other constitutional provisions. Those in the national constitution are:

## 1. Powers of congress:

U. S. Const., Art. I, § 8. *Congress* shall have the power: To lay and collect taxes, duties, imposts and excises, to pay the debts and provide for the common defense and general welfare of the United States.

To borrow money on the credit of the United States.

To regulate commerce with foreign nations and among the several states, and with the Indian tribes.

To coin money, regulate the value thereof, and of foreign coin.

To establish post-offices and post-roads.

To make all laws which shall be necessary and proper for carrying into execution the foregoing powers and all other powers vested by this constitution in the government of the United States, or in any department or officer thereof.

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Sec. 407. 2. Limits on powers of congress:

U. S. Const., Art. I, § 2. Representatives and direct taxes *shall* be apportioned among the several states \* \* \* according to their respective numbers. \* \* \*

U. S. Const., Art. I, § 9. No bill of attainder or *ex post facto* law shall be passed.

No capitation or other direct tax shall be laid, unless in proportion to the census. \* \* \*

No tax or duty shall be laid on articles exported from any state.

No preference shall be given by any regulation of commerce or revenue to the ports of one state over those of another; nor shall vessels bound to or from one state be obliged to enter, clear or pay duties in another.

Am. U. S. Const., Art. V. No person shall be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty or property without due process of law; nor shall private property be taken for public use, without just compensation.

*Note.* This article does not apply to corporations: 1900, *State v. Standard Oil Co.*, 61 Neb. 28, 84 N. W. 413, 87 Am. St. R. 449.

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Sec. 408. 3. Limits on powers of the states:

U. S. Const., Art. I, § 10. No state shall \* \* \* coin money; emit bills of credit; make anything but gold and silver coin a tender in payment of debts; pass any bill of attainder, *ex post facto* law or law impairing the obligation of contracts. \* \* \*

No state shall, without the consent of congress, lay any imposts or duties on imports or exports, except what may be necessary for executing its inspection laws; and the net produce of all duties and imposts laid by any state on imports and exports shall be for the use of the treasury of the United States; and all such laws shall be subject to the revision and control of the congress.

No state shall, without the consent of congress, lay any duty of tonnage. \* \* \*

**Sec. 409. 4. General provisions:**

U. S. Const., Art. IV, § 2. The citizens of each state shall be entitled to all privileges and immunities of citizens in the several states.

U. S. Const., Art. VI. This constitution, and the laws of the United States which shall be made in pursuance thereof; and all treaties made, or which shall be made, under the authority of the United States, shall be the supreme law of the land; and the judges in every state shall be bound thereby, anything in the constitution or laws of any state to the contrary, notwithstanding.

U. S. Const., Am. Art. XIV. All persons born or naturalized in the United States and subject to the jurisdiction thereof, are citizens of the United States and of the state wherein they reside.

No state shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States;

Nor shall any state deprive any person of life, liberty or property without due process of law;

Nor deny to any person within its jurisdiction the equal protection of the laws.

**5. State constitutional limitations:**

These, so far as they apply to corporations, usually are such as relate in a general way to the protection of individual rights, as "no person shall be deprived of life, liberty or property without due process of law," "the right to trial by jury shall be inviolate," etc., and such as prevent the granting of special privileges, or the creation of corporations by special act.

See *supra*, §§ 6, 7, 57, 58, 68-75.

**SUBDIVISION II. THE STATE AND ITS OWN CORPORATIONS.****ARTICLE I. CONTROL BY THE COURTS.****Sec. 410. (1) Methods in general.**

LYON, J., IN THE STATE, *EX REL.* CUPPEL, *v.* MILWAUKEE CHAMBER OF COMMERCE.

1879. IN THE SUPREME COURT OF WISCONSIN. 47 Wis. 670, on 679-80.

"The visitorial or superintending power of the state over corporations created by the legislature will always be exercised, in proper cases, through the medium of the courts of the state, to keep those corporations within the limits of their lawful powers, and to correct and punish abuses of their franchises. To this end the courts will issue writs of *quo warranto*, *mandamus*, or *injunction*, as the exigen-

cies of the particular case may require; will inquire into the grievance complained of, and, if the same is found to exist, will apply such remedy as the law prescribes. Every corporation of the state, whether public or private, civil or municipal, is subject to this superintending control, although in its exercise different rules may be applied to different classes of corporations."

*Note.* As to history of *quo warranto*, and information in nature of *quo warranto*: 1698, *The Mayor v. Hertford*, 1 *Ld. Raym.* 426; 1725, *Sir Wm. Lowther's Case*, 2 *Ld. Raym.* 1409; 1726, *Ibbotson's Case*, *Lee t. Hardw.* 261; 1757, *R. v. Williams*, 1 *Burr.* 402; 1772, *R. v. Gregory*, 4 *T. R.* 240 *n.*; 1785, *R. v. Stacey*, 1 *T. R.* 1; 1819, *R. v. Trevenen*, 2 *Barn. & Ad.* 339; 1829, *R. v. Ogden*, 10 *Barn. & Cress.* 233; 1846, *Darley v. The Queen*, 12 *Cl. & F.* 520, 536, *et seq.*

As to *scire facias*: 1847, *State v. Merchants' Trust Co.*, 8 *Humph. (Tenn.)* 235; 1851, *The State v. Moore*, 19 *Ala.* 514; 1862, *Commw. v. Delaware, etc.*, *Co.*, 43 *Pa. St.* 295; 1885, *Green v. St. Albans Trust Co.*, 57 *Vt.* 340.

## Sec. 411. (2) Power of courts to issue the necessary writs.

### STATE, EX REL. LAMB, v. CUNNINGHAM.<sup>1</sup>

1892. IN THE SUPREME COURT OF WISCONSIN. 83 *Wis. Rep.* 90-170, 35 *Am. St. Rep.* 27.

[Action for purpose of restraining the defendant, as secretary of state, from publishing election notices in certain newspapers, and filing and preserving in his office certificates of nomination, etc. The suit involves the authority of courts in matters of *quo warranto*, *mandamus*, *injunction*, etc.]

CASSODAY, J. I. Counsel for the defendant challenges the jurisdiction of this court in this cause, and supports such contention with much learning and ability. The question of the original jurisdiction or power of this court under sec. 3, art. vii, of the constitution, "to issue writs of *habeas corpus*, *mandamus*, *injunction*, *quo warranto*, *certiorari*, and other original and remedial writs, and to hear and determine the same," has frequently been considered by this court.

(Citing many cases.) \* \* \*

Among the propositions so firmly established as to require no further exposition from this court are those to the effect that the constitutional clause quoted "was designed to give this court original jurisdiction of all judicial questions affecting the sovereignty of the state, its franchises or prerogatives, or the liberties of the people;" that such prerogative writs, including *injunction* as a *quasi*-prerogative writ, can properly issue only at the suit of the state or the attorney-general in the right of the state; that "in matters strictly *publici juris*, in which no one citizen has any right or interest other than that which is common to citizens in general, a petition by a private person for leave to commence an action in this court in the name of the state can not

<sup>1</sup> Statement abridged, and only part of opinion given. Arguments omitted.

properly be considered until the attorney-general has been requested to move in the matter, and has refused or unreasonably delayed to do so;" that in all cases in which an exercise of such original jurisdiction is sought, whether by such private citizen or the attorney-general, leave must first be obtained from this court upon a *prima facie* showing that the case is one calling for the exercise of such jurisdiction; that the official acts of the secretary of state in issuing or publishing notices of an election of members of the legislature under an apportionment act alleged to be invalid, are purely ministerial; and hence, in the exercise of such original jurisdiction, this court may control the same either by *mandamus* or injunction as the exigencies of the case may require. We do not understand counsel for the defendant to question the correctness of the decision in *State, ex rel. Att'y-Gen., v. Cunningham*, 81 Wis. 440; and hence it is, in effect, conceded that the court has jurisdiction of the subject-matter of the case at bar.

The precise objection to the jurisdiction here presented is that its exercise has not been invoked by the attorney-general, and hence, that the court is powerless to consider the case at all without his consent and co-operation. In *State, ex rel. Wood, v. Baker*, 38 Wis. 80, 81, Ryan, C. J., said: "The jurisdiction conferred on this court by the constitution is of *informations* in the nature of *quo warranto*, as substituted in modern times for the use of the ancient writ itself, and as used when the constitution was framed. This was a prerogative proceeding, *quasi-criminal* and *quasi-civil* in its character, according to its use, but always classed with criminal informations.

\* \* \* The mode of proceeding under this jurisdiction might be regulated by statute, *but the jurisdiction itself could not be defeated or abridged.* \* \* \* It was undoubtedly competent for the legislature to give a *quasi-civil* proceeding in such cases, but not to abolish the *quasi-criminal* jurisdiction vested in the court by the constitution. This appears to us to be a matter of substance, not of form." \* \* \*

In *Attorney-General v. Railroad Cos.*, 35 Wis. 512-523, Chief Justice Ryan said, among other things: "The grant of original jurisdiction is *one entire* thing, given in *one general policy*, for one *general* purpose, though it may have many objects and many modes of execution." \* \* \*

He then contrasted injunction and *mandamus*, and said: "The latter commands, the former forbids. Where there is nonfeasance, *mandamus* compels duty. Where there is malfeasance, injunction restrains wrong. And so near are the objects of the two writs, that there is sometimes doubt which is the proper one; injunction is frequently mandatory, and *mandamus* sometimes operates restraint.

\* \* \* And it is very safe to assume that the constitution gives injunction to restrain excess in the same class of cases as it gives *mandamus* to supply defect, the use of the one writ or the other in each case turning solely on the accident of overaction or shortcoming of the defendant. And it may be that where defect and excess meet in a single case, the court might meet both, in its discretion, by one of the writs, without being driven to send out both, tied together with

red tape, for a single purpose. \* \* \* The prerogative writs proper can issue only at the suit of the state *or* the attorney-general in the right of the state; *and so it must be with the writ of injunction*, in its use as a *quasi*-prerogative writ. *All* may go on the relation of a private *person*, and may involve private right."

The "one entire thing"—the "one general policy"—the "one general purpose" to be accomplished through the "one jurisdiction" by the five several writs grouped together in one clause of the constitution, as mentioned by the learned chief justice, manifestly has reference to "judicial questions affecting the sovereignty of the state, its franchises or prerogatives, or the liberty of its people;" for it is only of such, as therein indicated, that this court takes original jurisdiction at all. The irresistible logic of the opinion is to the effect that the power to thus issue the five writs thus grouped together, for the one purpose named, was by the clause of the constitution quoted vested in this court absolutely and unconditionally, and is in no way dependent upon the volition of the attorney-general or any other official. This is confirmed by what he said in *State, ex rel. Wood, v. Baker*, 38 Wis. 71, quoted above, to the effect that, while the legislature might regulate the mode of procedure in such cases, they could not defeat nor abridge the jurisdiction itself; that the appearance in the case by the attorney-general, or his consent, was a mere matter of form and not of substance, and hence could be supplied upon the hearing *nunc pro tunc*. Indeed, it would be a solecism to hold, as his court frequently has held in several of the cases cited, to the effect that the attorney-general has no right or power to commence such an action, much less to prosecute it, without first obtaining leave from this court, and then hold that this court has no power to take jurisdiction in any such case without first obtaining the permission of the attorney-general. This court can not play fast and loose with the subject of jurisdiction. It either has it absolutely whenever a proper cause is presented, or else it has not got it at all. If it has jurisdiction in such a cause, it is because it has been conferred on the court by the people in their sovereign capacity, in the clause of the organic law quoted. If such jurisdiction is thereby vested in the court—as must be conceded by all—then it would seem to be idle to deny the jurisdiction in such action merely because the attorney-general has refused to co-operate or consent. \* \* \*

*Note.* State can not maintain *quo warranto* against a railroad corporation for charging excessive rates, as this is a matter of private concern only. 1903, *State v. Atchison, etc., Ry. Co.*, 176 Mo. 687, 63 L. R. A. 761; *contra*, in *Louisiana*, 1902, *New Orleans Water Co. v. Louisiana*, 185 U. S. 336.



**Sec. 412.** A. By courts of law. (1) By *quo warranto*, *scire facias*, or information in nature of *quo warranto*.

PEOPLE, Ex REL. ATTORNEY-GENERAL, v. THE DASHAWAY ASSOCIATION.<sup>1</sup>

1890. IN THE SUPREME COURT OF CALIFORNIA. 84 Cal. Rep. 114-123.

[Information in nature of *quo warranto* to forfeit the charter of the association, and escheat the property to the state. The corporation was organized to promote temperance; it had no capital stock, but had acquired property by gift and otherwise to the extent of over \$111,000, of which it was alleged \$72,000 had been perverted from the use for which it was designed by paying the same to its members, and that it proposes to distribute the remaining \$39,000. The defendant demurred, and this was sustained in the court below, with judgment for defendant, from which the relator appeals.]

BY THE COURT. \* \* \* Corporations are creatures of the law, and when they fail to perform duties which they were incorporated to perform, and in which the public have an interest, or do acts which are not authorized or are forbidden them to do, the state may forfeit their franchises and dissolve them by an information in the nature of a *quo warranto*. (People v. Utica Ins. Co., 15 Johns. 358, 8 Am. Dec. 243; People v. Pittsburg R. R. Co., 53 Cal. 694; Golden Rule v. People, 118 Ill. 492.)

The grant of corporate franchises is always subject to the implied condition that they will not be abused. (Chicago Life Ins. Co. v. Needles, 113 U. S. 574.)

"In its relation to the government, and when the acts or neglects of a corporation, in violation of its charter or of the general law, become the subject of public inquiry, with a view to the forfeiture of its charter, the willful acts and neglects of its officers are regarded as the acts and neglects of the corporation, and render the corporation liable to a judgment or decree of dissolution." (Angell and Ames on Corporations, section 310; Life Ins. Co. v. Mechanics' Ins. Co., 7 Wend. 31; Bank Commissioners v. Bank of Buffalo, 6 Paige 497; Ward v. Sea Ins. Co., 7 Paige 294.)

This reasoning proceeds upon the theory that the corporation is cognizant of and approves of the acts of its agents; and where it is made to appear that the agent has departed from his duties as prescribed by the corporation, or violated his instructions in the performance of the acts complained of and relied upon as a basis for forfeiture, no such forfeiture will be declared. (State v. Commercial Bank, 6 Smedes & M. 237.)

In People v. Utica Ins. Co., 15 Johns. 358, 8 Am. Dec. 243, an application had been previously made by the attorney-general to a court of chancery for an injunction to restrain the company from

<sup>1</sup> Statement abridged; part of opinion omitted.

usurping the franchise of banking, which application was refused because there was a complete and adequate remedy at law by an information in the nature of a *quo warranto*. *People v. Bank of Niagara*, 6 Cow. 196; *People v. Washington and Warren Bank*, 6 Cow. 211, and *People v. Bank of Hudson*, 6 Cow. 217, are authority to the point that the action is properly brought in the name of the people, and against the corporations in their corporate names, in cases where they had, as corporations, usurped franchises not granted by their charters. (See also, *People v. Trustees of Geneva*, 5 Wend. 211.)

The writ of *scire facias* was formerly used by government as a mode to ascertain and enforce the forfeiture of a corporate charter, in cases where there was a legal existing body capable of acting, but who had abused their power. It would not lie in cases of mere *de facto* corporations. It was necessary that the government be a party to the suit, for the judgment was that the parties be ousted and the franchises seized into the hands of the government. (2 Kent's Com., 313.)

The writ of *quo warranto* was a writ which issued to bring the defendant before the court to show by what authority he claimed an office or franchise, and was applicable alike to cases where the defendant never had a right, or where, having a right or franchise, he had forfeited it by neglect or abuse. (3 Bla. Com., 262, 263.)

An information in the nature of *quo warranto*, which has succeeded the writ of that name, was originally in form a criminal proceeding to punish the usurpation of the franchise by a fine, as well as to seize the franchise. This information has, in process of time, become, in substance, a civil proceeding to try the mere right to the franchise or office.

It was a peculiarity of both the *quo warranto* and information in the nature of *quo warranto* that the ordinary rule of pleading was reversed, and the state was bound to show nothing, and the defendant was required to show his right to the franchise or office in question, and if he failed to show authority, judgment went against him. (Angell and Ames on Corporations, section 756.)

The practice has, however, become quite general in this country for the information to set forth the facts relied upon to show the intrusion, misuser or non-user complained of.

In information of *quo warranto* there were two forms of judgment. When against an officer or individual, the judgment was *ouster*, when against a corporation by its corporate name, the judgment was *ouster* and *seizure*.

In the first case, there being no franchise forfeited, there is none to seize; in the second case there is, consequently the franchise is seized. (2 Kent's Com., 312, and note.)

But there may be a judgment of *ouster* of a particular franchise, and not of the whole charter. (*People v. S. & R. R. Co.*, 15 Wend. 113.)

By such *ouster* and *seizure* the franchises are not destroyed, but

pass to and exist in the state. The corporation was destroyed, and ceased to be the owner or possessor of lands, or goods, or rights, or credits. The lands reverted to the grantor and his heirs, and the goods escheated to the state.

The principle of a forfeiture is, that the franchise is a trust; and the terms of the charter are conditions of the trust, and if any one of the conditions of the trust be violated, it will work a forfeiture of the charter.

Cases of forfeiture are said to be divided into two great classes:

1. *Cases of perversion*; as where a corporation does an act inconsistent with the nature and destructive of the ends and purposes of the grant. In such cases, unless the perversion is such as to amount to an injury to the public, who are interested in the franchise, it will not work a forfeiture.

2. *Cases of usurpation*; as where a corporation exercises a power which it has no right to exercise. In this last case the question of forfeiture is not dependent, as in the former, upon any interest or injury to the public. \* \* \*

(The court here showed that in 1872, the writs of *scire facias*, *quo warranto*, and information in the nature of *quo warranto*, were abolished, and an action by the attorney-general in the name of the people substituted therefor; but that the Code of 1880 reinstated the writ of *quo warranto*; the form of proceeding was therefore held to be sufficient.)

The vital question, however, remaining in either case is this: Has there been a perversion by the defendant of its funds under such circumstances as to amount to an injury to the public? \* \* \*

We are of the opinion that the term used in the information here is too vague and uncertain to enable us to say therefrom that the fund in question is a public charity, which can be administered by a court of equity.

It follows that the perversion of the fund is not an injury to the public, and hence that the forfeiture can not be maintained.

The judgment is affirmed.

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**Sec. 413. Same. Abuse and misuse, meaning of.**

See *Erie and Northeast Railroad Company v. Casey*, 26 Pa. St. 287, 318; *infra*, p. 1435, on 1442.

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**Sec. 414. Same. Illustrations of use of *quo warranto* to forfeit for abuse, misuse or perversion.**

(a) Unlawful combinations: *People v. North River Sugar Ref. Co.*, 121 N. Y. 582, *supra*, p. 100; *People v. Chicago Gas Trust Co.*, 130 Ill. 268, *supra*, p. 1054; *Distilling, etc., Co. v. People*, 156 Ill. 448, *supra*, p. 978.

*Note.* See, also, 1862, *Washington, etc., Road Co. v. State*, 19 Md. 239; 1879, *State of Ohio v. Oberlin, etc., Assn.*, 35 Ohio St. 258; 1890, *State v. Nebraska Distilling Co.*, 29 Neb. 700; 1892, *State v. Standard Oil Co.*, 49 Ohio St. 137; 1892, *People v. Buffalo Stone, etc., Co.*, 131 N. Y. 140; 1895, *People v. Milk Exchange*, 145 N. Y. 267, 45 Am. St. R. 609; 1897, *Hartnett v. Plumbers' Assn.*, 169 Mass. 229, 38 L. R. A. 194, 7 Am. & E. C. C. (N. S.) 183; 1897, *People v. Chicago L. S. Ex.*, 170 Ill. 556, 62 Am. St. R. 404; 1899, *Independent Med. Col. v. People*, 182 Ill. 274, 55 N. E. Rep. 345; 1899, *State v. Portland Natural Gas Co.*, 153 Ind. 483, 53 N. E. Rep. 1089, 53 L. R. A. 413; 1899, *National Lead Co. v. Grote P. S.*, 80 Mo. App. 247; 1900, *State v. Buckeye Pipe Line Co.*, 61 Ohio St. 520, 56 N. E. Rep. 464; 1900, *Crystal Ice Co. v. State*, 23 Tex. Civ. App. 293, 56 S. W. Rep. 562; 1901, *State v. Dairy Co.*, 62 O. S. 350, 57 L. R. A. 180.

See notes 8 Am. St. R. 179, *et seq.*; 100 Am. Dec. 268; 30 Am. Dec. 44; 1832, *Chesapeake & O. Canal Co. v. B. & O. R.*, 4 Gill & J. 1; 1839, *McIntire Poor School v. Zanesville, etc., Co.*, 9 Ohio 203, 34 Am. Dec. 436; 1842, *State v. N. O. G. L. & B. Co.*, 2 Rob. (La.) 529; 1849, *Lumbard v. Stearns*, 4 Cush. (Mass.) 60; 1903, *State v. Atchison, etc., Ry. Co.*, 176 Mo. 687, 63 L. R. A. 761; also, 185 U. S. 336.

(b) Illegal insurance: *State v. Standard Life & Acc. Assn.*, 38 Ohio St. 281, *supra*, p. 1234.

*Note.* See, 1883, *State v. Mut. Aid, etc., Assn.*, 38 Ohio St. 300; 1898, *State v. Mut. Life Ins. Co.*, 59 Kan. 772, 51 Pac. Rep. 881; 1899, *State v. Fireman's Fund Ins. Co.*, 52 S. W. Rep. 595; 1899, *Ætna Ins. Co. v. Commonwealth*, 21 Ky. L. Rep. 503, 45 L. R. A. 355, 51 S. W. Rep. 624; 1899, *State v. Ætna Ins. Co.*, 150 Mo. 113, 51 S. W. Rep. 413.

(c) Illegal banking: *State Bank v. State*, 1 Blackf. (Ind.) 267, *supra*, p. 891; *People v. Utica Ins. Co.*, 15 Johns. (N. Y.) 358, *supra*, p. 113.

*Note.* See, also, 1826, *People v. Bank of Niagara*, 6 Cowen 196; 1840, *People v. Phoenix Bank*, 24 Wend. 431; 1841, *State v. Com. Bk. of Cin.*, 10 Ohio St. 535; 1855, *State v. Seneca Co. Bank*, 5 Ohio St. 172; 1857, *Commonwealth v. Commercial Bank*, 28 Pa. St. 383; 1859, *State v. Bank of Manchester*, 33 Miss. 474.

(d) Fraudulent organization: *Holman v. State*, 105 Ind. 569, *supra*, p. 590.

See, 1866, *Commonwealth v. Central Penna. R. Co.*, 52 Pa. St. 506; 1892, *State v. Webb*, 97 Ala. 111, 38 Am. St. Rep. 151; 1898, *Benton v. Minneapolis Tailoring Co.*, 73 Minn. 498, 76 N. W. Rep. 265; 1898, *First Nat'l Bk. v. Trebein Co.*, 59 Ohio St. 316, 52 N. E. Rep. 834.

Compare, 1879, *Rice v. National Bank*, 126 Mass. 300; 1900, *Kingman & Co. v. Mowry*, 182 Ill. 256, 55 N. E. Rep. 330.

(e) Willful or negligent non-user:

See, 1831, *State v. Pasumpsic Tp. Co.*, 3 Vt. 178; 1839, *People v. Royalton, etc., Tp. Co.*, 11 Vt. 431; 1839, *McIntire Poor School v. Zanesville, etc., Canal Co.*, 9 Ohio 203, 34 Am. Dec. 436; 1842, *State v. N. O. Gas L. & B. Co.*, 2 Rob. (La.) 529; 1862, *Washington, etc., Tp. Road v. State*, 19 Md. 239; 1862, *People v. Albany, etc., R. Co.*, 24 N. Y. 261, 82 Am. Dec. 295; 1867, *State v. Pawtuxet Tp. Co.*, 8 R. I. 521, 94 Am. Dec. 123; 1875, *Harris v. Miss. Valley, etc., R. Co.*, 51 Miss. 602; 1875, *Coon v. Plymouth Plank-Road Co.*, 32 Mich. 248; 1879, *People v. Pittsburgh R. Co.*, 53 Cal. 694; 1881, *State v. Council Bluffs, etc., Ferry Co.*, 11 Neb. 354; 1881, *Ward v. Farwell*, 97 Ill. 593; 1882, *State v. Pipher*, 28 Kan. 127; 1886, *State v. Minnesota, etc., R. Co.*, 36 Minn. 246; 1887, *Darnell v. State*, 48 Ark. 321; 1895, *People v. Plainfield Gravel R. Co.*, 105 Mich. 9, 62 N. W. Rep. 998.

**Sec. 415. Same.** To oust for usurpation. Proceedings.

**STATE v. DEBENTURE GUARANTEE & LOAN COMPANY.<sup>1</sup>**

1899. IN THE SUPREME COURT OF LOUISIANA. 51 La. Ann. Rep.  
1874-1889, 26 So. R. 600.

[Suit by the state to have the charter of the Debenture Company declared null and void, because not authorized by law, or if found to be authorized, to declare a forfeiture of it for misuser. It was alleged that the company was organized under an act of 1888, allowing three persons to incorporate for the purpose of carrying "on any lawful business or enterprise not otherwise specially provided for," with a capital stock of \$120,000 in 10,000 shares of \$12 each, and authority to begin business when 1,000 shares were subscribed; its objects were to buy, sell and guarantee the payment of debentures, and loan money on the same; and in order to do so to levy an assessment or premium upon the same to be paid in advance, and the debenture to be redeemed at a time agreed upon by the premiums paid and forfeited for non-payment. It was forbidden to engage in stock jobbing of any kind. The company defended upon the ground that the state was not an interested party, that the matters involved related to purely private business transactions between citizens, and not to the exercise of any public franchise or function of the state. These defenses were overruled, and upon a hearing the charter was annulled. Defendant appealed.]

NICHOLLS, C. J. \* \* \* The right of the state to inaugurate proceedings against an existing corporation for forfeiture of its charter, for specially assigned and properly pleaded grounds, is not, we think, disputed. If we apprehend defendant's position, it is, that the state, after the general assembly had authorized by statute the formation of corporations for "any lawful business," and parties have acted upon that statute, can not inaugurate proceedings to have the corporation declared "non-existent," for the reason that in the opinion of the attorney-general or other state officials, the object and purposes of the corporation were not wise nor judicious, but that the operation of the corporation would be bound to terminate ultimately in disaster to all parties.

That it would require legislative action of some kind to place a particular kind of business under the ban, or to authorize judicial proceedings against corporations following that particular kind of business, to warrant or justify such an action.

The right of individuals to organize themselves into a corporation, is not an original, but a derivative and expressly conferred right.

Legislative authority is essential to its exercise, and hence it is that corporations in describing themselves either in judicial pleadings or authentic acts, always refer to themselves as a corporation created and organized under the laws of Louisiana.

<sup>1</sup> Statement abridged, and part of opinion omitted. This case was affirmed by supreme court of the United States, 180 U. S. 320.

The body having authority to bestow such a right or privilege has necessarily the power and authority to select the object and purposes for which it can and shall be granted, and to attach such conditions and limitations as it may think proper to the exercise of the right.

Before the passage of general laws on this subject, the general assembly acted itself directly upon individual cases presented to it for its consideration.

The granting of the right by act of the general assembly in a special case carried with it as a consequence legislative recognition and approval of the public utility and advantage of that corporation, and thus removed and withdrew, unless under extraordinary circumstances, the propriety of the existence of the same from judicial control.

In course of time, the legislature thought proper to announce in advance in general terms certain objects as commanding their approval, and permitted parties to form corporations for such purposes on declared terms and conditions. \* \* \*

The matter of the public utility and advantage of the corporations to be formed was left at large; and especially was this the case in act No. 36 of 1888.

Throughout the whole legislation and behind it, had constantly rested the principle that corporations should be created "for the promotion of some object of general utility" and for none other.

It can not be conceived that the legislature should have ever intended to confer upon three or more persons the right to determine of themselves and for themselves (and that finally) that the objects for which they were about to organize were legal and useful and proper, and to be permitted on the strength of that conclusion to do business as such without let or hindrance from any quarter, except in cases of violation of the provisions of their various charters. \* \* \*

There are so many possible injuries to result in different ways and to different persons from unauthorized action of this character, that the right of the state to put an end to it, if existing, can not, we think, be properly questioned.

To permit a small number of persons to operate in business to an indefinite extent, under exceptional limited liability, without the necessity of making report at any time of the changing, shifting conditions of such business, and without any official authority provided for supervision over their action, is an extraordinary and dangerous condition of things, and the only wonder is that more disastrous results should not have followed from its existence than seems to have been the case.

The state has, undoubtedly, the right to be heard in this case. \* \* \*

It is urged that the state by citing the defendant as a corporation, and through parties acting as officers of a corporation, has admitted the existence of the corporation and estopped itself from contesting the same.

It is claimed that the action, if admissible at all, should have been directed against the parties who organized the corporation or those



claiming to be now members of it. There is no force whatever in that proposition. When the parties who signed the act by which this defendant is claimed to have come into existence as a corporation did so, they ceased to have any authority to represent individually the rights or obligations of the intellectual body which they claim to have thus created, a body which, if it really existed, was (under the terms of our civil code) a body separate and distinct from the persons who composed it.

A judgment declaring the corporation never to have existed, or declaring its charter forfeited, if held to have ever existed, would not be *res judicata* against the body itself if not present and represented in the litigation by its declared legal representatives. \* \* \*

The real self-styled corporation has a right to be heard in the matter; in fact, no effective judgment could be rendered in the premises without it. \* \* \*

There are good reasons why all the present stockholders should not be made parties; in the first place, they are too numerous, and in the next place, their names were not of record in the recorder's office when this suit was brought, and the state could not be expected to know, or be called upon to ascertain who they were. We see no inconsistency in calling the defendant into this litigation as a corporation and citing it as a corporation through its officers and asking the court to declare that it had never had existence as such. *Homestead Co. v. Lingman*, 46 Ann. 1123.

The parties who are acting on its behalf do not pretend to be acting on their own account.

The wrong asserted by the state, and so far as the state is concerned is, that certain business is being carried on under the sanction of its name without right or authority, and that this condition of things should be stopped by injunction.

The state is not attacking the business carried on as an illegal business, carried on by the parties as individuals, but as carried on as a corporation.

For that purpose, the parties representing the so-called corporation are certainly those with whom the state should proceed contradictorily.

The demand of the state, if sustained, will certainly have its correct legal result—the discontinuance of the business under the guise of its being conducted by a corporation under a limited liability on the part of those connected with it.

There is no more inconsistency in bringing defendant into court as a corporation to have it declared to be not such, than there would be to allege in a pleading the existence of a judgment, and to pray that it be decreed to have been and to be an absolute nullity, nor to bring into court a party as a husband to have his marriage with the plaintiff decreed never to have legally existed.

The existing *status* is recognized temporarily, solely for the very avowed purpose of having it declared to be without foundation. We think the attorney-general was vested with full authority to bring this action on behalf of the state. \* \* \*

(The court held that the business of defendant was in effect stock-jobbing, and that it had begun business before the 1,000 shares were subscribed, and for these reasons affirmed the decision below).

Compare as to pleading, 1901, *People v. Cent. U. Tel. Co.*, 192 Ill. 307, 85 Am. St. R. 338.

### Sec. 416. Same. Illustrations of ouster for usurpation.

(a) Unlawful purpose: *People v. Insurance Co.*, 15 Johns. 358, *supra*, p. 113; *Attorney-General v. Lorman*, 59 Mich. 157, *supra*, p. 605.

See note, 8 Am. Rep. 179; 57 L. R. A. 180; 60 L. R. A. 448.

(b) Imperfect or insufficient organization: *State v. Dawson*, 16 Ind. 40, *supra*, p. 412; *State v. Insurance Co.*, 49 Ohio St. 440, *supra*, p. 406; *Commonwealth v. Cullen*, 13 Pa. St. 133, *supra*, p. 417; *Philadelphia v. Sav. Inst.*, 1 Whart. 461, *supra*, p. 464.

(c) Continuing to exercise corporate powers after expiration of charter: *State v. Payne*, 129 Mo. 468, *supra*, p. 830.

(d) Intrusion into office by illegal election of corporate officers: *State v. Parsons*, 40 N. J. Law 1, *supra*, p. 333; *Commonwealth v. Cullen*, 13 Pa. St. 133, *supra*, p. 417.

### Sec. 417. Same. Statute of limitations.

#### STATE OF RHODE ISLAND v. PAWTUXET TURNPIKE COMPANY.<sup>1</sup>

1867. IN THE SUPREME COURT OF RHODE ISLAND. 8 R. I. Rep. 521-526, 94 Am. Dec. 123.

[Application by the defendants for a rehearing upon an information in the nature of *quo warranto*, and to set aside the former judgment of forfeiture.]

DURFEE, J. The leading ground assigned for this application is, that the prosecution was not instituted in behalf of the state until after a lapse of over six years from the happening of the cause of forfeiture; and we are referred to Angell and Ames on Corporations (7th ed.), § 743, and the cases there cited, as showing that after the lapse of so long a time, we ought not to entertain the proceeding. The cases cited in Angell and Ames show that the English rule is, not to allow an information in the nature of a *quo warranto* to be filed, *at the instance of a private individual*, for the purpose of impeaching the title to a corporate office or purchase, where the same has been held or exercised without complaint for more than six years from the time of the alleged usurpation. An information in the nature of a *quo warranto* can not be filed by a private individual without leave, which

<sup>1</sup>Part of opinion omitted.

the court may, at its discretion, either grant or refuse. To regulate their discretion, as affected by the lapse of time, the English courts adopted the rule which we have stated. But the attorney-general, representing the crown in England and the state in this country, may file an information in the nature of a *quo warranto*, without leave, according to his own discretion; and we find no English law which holds that an information, so filed, can be barred by the lapse of six years independently of any statute to that effect. On the contrary, in the leading case of *Rex v. Wardroper*, 4 Burr. 1963, where, after a lapse of nineteen years, the court refused leave to file an information, the judges were careful to express a reservation in favor of the crown, and said: "Indeed, no length of usurpation shall affect the crown, *nullum tempus occurrit regi*." The only case which we find that claims a discretion for the court, in this regard, over an information filed by the attorney-general, is the *People v. Oakland County Bank*, 1 Douglas (Mich.) R. 285. The court in that case do not profess to follow any precedent, but stand on their own opinion of what is salutary and reasonable. We think the case of *Rex v. Wardroper*, *supra*, declares the sounder doctrine. The attorney-general being a *public* officer, may be presumed to be capable of a salutary and reasonable discretion, as well as the court, and when, acting in behalf of the state, he deems it his duty to prosecute for a forfeiture, it is not for the court, in the absence of any statutory limitation, to say he is too late. Indeed this court has itself decided that, after the information has once been filed, its discretion ceases, and it has then nothing to do but administer the law the same as in any other case. *State v. Brown*, 5 R. I. 1. \* \* \*

*Application dismissed.*

See, also, 1888, *People v. Stanford*, 77 Cal. 360, 18 Pac. Rep. 85; and note in 52 Am. St. R. 312.

## Sec. 418. Same. Waiver.

### THE PEOPLE v. THE PHOENIX BANK.

1840. IN THE SUPREME COURT OF NEW YORK. 24 Wend. (N. Y.) Rep. 431-434.

[Information in nature of *quo warranto* against the defendants for claiming to be and acting as a corporation.]

BRONSON, J. \* \* \* The attorney-general alleges that the defendants have forfeited their corporate privileges by taking usury. The defendants answer that a state director has since been appointed by the governor and senate; and this act, they insist, amounts to a waiver or pardon of the forfeiture. The conclusion does not follow from the premises.

No one could take advantage of the forfeiture in a collateral manner. It could only be asserted by a direct legal proceeding on the

part of the government to dissolve the corporation. Notwithstanding the existing cause of forfeiture, the defendants were a corporation *de facto*, and might continue to exercise their franchise until judgment of ouster should be pronounced against them. In the meantime, it was the duty of the governor and senate, as well as all others, to treat the defendants as a legally existing corporation. The appointment of a state director was, therefore, perfectly consistent with the intention to continue this prosecution and insist on the forfeiture.

Should it be conceded that the governor and senate had a dispensing power, it does not appear that the power has been exercised. \* \* \*

But I must not be understood as admitting that the governor and senate, without the concurrence also of the assembly, had any dispensing power. They had no more authority to waive or pardon the forfeiture than any other public officer or body of men. Indeed, the attorney-general had more power over this matter than the governor and senate united; for if he refused to prosecute, the wrong charged upon the defendants would go unpunished, and the corporation would continue to exist and enjoy its privileges in the same manner as though there had been no violation of the charter. Still, the neglect to prosecute would not amount to a pardon; it could only operate as a waiver so long as the omission continued, and would be no answer to a *quo warranto* whenever he, or his successor in office, might choose to insist on the penalty.

In England, where corporations may be created by royal charter, the king can pardon a forfeiture by granting a restitution; but he has, I think, no such power in relation to corporations created by act of parliament. *The King v. Amery*, 2 T. R. 568, 569; *Newling v. Francis*, 3 T. R. 189; *The King v. Miller*, 6 T. R. 277. So here, where corporations are created by the legislature, that body can waive the forfeiture, by ratifying and confirming the original grant. *The People v. The Manhattan Company*, 9 Wendell 351. But no other body of men has any such dispensing power. The franchise is granted upon condition that it shall become void in case of misuser; and although the corporation will continue to exist until the forfeiture is asserted in the forms prescribed by law, the condition can only be changed, or the penalty released, by the power which made the original grant. The legislature may, perhaps, delegate its authority to pardon the offense; but that has not been done.

*Judgment for people.*

See, 1844, *State v. Fourth N. H. Tp. Co.*, 15 N. H. 162; 1891, *People v. Ulster & D. R. Co.*, 128 N. Y. 240.

**Sec. 419. (2) Mandamus.****(a) Specific duty.**

See *State v. N. E. R. Co.*, 9 Rich. Law (S. C.) 247, 67 Am. Dec. 551, *supra*, p. 44.

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**Sec. 420. Same.****PEOPLE v. N. Y. CENTRAL & HUDSON RIVER RAILROAD COMPANY.<sup>1</sup>**

1883. IN THE SUPREME COURT OF NEW YORK. 28 Hun (N. Y.)  
Rep. 543-560.

[Appeal from orders granting motion to quash, and denying application by the attorney-general for a peremptory writ of mandamus, commanding the railroad company to forthwith operate their road, and receive and transport freight as usual. The company's excuse for not so doing since June, 1882, was a strike of its employes for higher wages not alleged to be accompanied by violence, riot or other unlawful interference.]

DAVIS, P. J. \* \* \* The question presented by the motion is one of signal importance. It is whether the people of the state can invoke the power of the courts to compel the exercise by railroad corporations of the most useful public functions with which they are clothed. If the people have that right, there can be no doubt that their attorney-general is the proper officer to set it in effective operation on their behalf. (1 R. S. 179, § 1; Code of Civ. Proc., § 1993; *People v. Halsey*, 37 N. Y. 344; *People v. Collins*, 19 Wend. 56.)

The question involves a consideration of the nature of this class of corporations, the objects for which they are created, the powers conferred and the duties imposed upon them by the laws of their creation and of the state. As bodies corporate, their ownership may be and usually is altogether private, belonging wholly to the holders of their capital stock; and their management may be vested in such officers or agents as the stockholders and directors under the provisions of law may appoint. In this sense they are to be regarded as trading or private corporations, having in view the profit or advantages of the corporators. But these conditions are in no just sense in conflict with their obligations and duties to the public. The objects of their creation are from their very nature largely different from those of ordinary private and trading corporations. Railroads are, in every essential quality, public highways, created for public use, but permitted to be owned, controlled and managed by private persons. But for this quality the railroads of the respondents could not lawfully exist.

<sup>1</sup> Statement abridged. Part of opinion omitted.

Their construction depended upon the exercise of the right of eminent domain, which belongs to the state in its corporate capacity alone, and can not be conferred, except upon a "*public use*." The state has no power to grant the right of eminent domain to any corporation or person for other than a public use. Every attempt to go beyond that is void by the constitution; and although the legislature may determine what is a necessary public use, it can not by any sort of enactment divest of that character any portion of the right of eminent domain which it may confer. This characteristic of public use is in no sense lost or diminished by the fact that the use of the railroad by the corporation which constructs or owns it must from its nature be exclusive. That incident grows out of the method of use which does not admit of any enjoyment in common by the public. The general and popular use of a railroad as a highway is, therefore, handed over exclusively to corporate management and control, because that is for the best and manifest advantage of the public. \* \* \*

In *Olcott v. The Supervisors*, 16 Wall. 678, 694, the supreme court of the United States adjudge:

"Whether the use of a railroad is a public or a private one, depends in no measure upon the question who constructed it or who owns it. It has never been considered a matter of any importance that the road was built by the agency of a private corporation. *No matter who is the agent, the function performed is that of the state. Though the ownership is private, the use is public.* \* \* \* The owners may be private companies, *but they are compellable to permit the public to use their works in the manner in which such works can be used.* That all persons may not put their own cars upon the road, and use their own motive power, has no bearing upon the question whether the road is a public highway. It bears only upon the mode of use, of which the legislature is the exclusive judge." \* \* \*

The maintenance and control of most other classes of public highways are so devolved, [upon public officers] and the performance of every official duty in respect of them may be compelled by the courts, on application of the state, while private damages may also be recoverable for individual injuries. The analogy between such officials and railroad corporations in regard to their relations to the state, is strong and clear, and so far as affects the construction and proper and efficient maintenance of their railways will be questioned by no one. It is equally clear, we think, in regard to their duty as carriers of persons and property. This springs sharply out of the exclusive nature of their right to do those things. On other public highways every person may be his own carrier; or he may hire whomsoever he will to do that service. Between him and such employe a special and personal relation exists, independent of any public duty, and in which the state has no interest. In such a case, the carrier has not contracted with the state to assume the duty *as a public trust*, nor taken the right and power to do it from the state by becoming the special donee and depositary of a trust. A good reason may, therefore, be assigned



why the state will not by *mandamus* enforce the performance of his contract by such a carrier. But the reason for such a rule altogether fails when the public highway is the exclusive property of a body corporate, which alone has power to use it, in a manner which of necessity requires that all management, control and user for the purposes of carriage must be limited to itself, and which, as a condition of the franchise that grants such absolute and exclusive power over and user of a public highway, has contracted with the state to accept the duty of carrying all persons and property within the scope of its charter, as a public trust.

The relation of the state to such a body is entirely different from that which it bears to the individual users of a common highway, as between whom and the state no relation of trust exists; and there is small reason for seeking analogies between them. It is the duty of the state to make and maintain public highways. That duty it performs by a scheme of laws, which set in operation the functions of its political divisions into counties, towns and other municipalities, and their officers. It can and does enforce those duties whenever necessary through its courts. It is not the duty of the state to be or become a common carrier upon its public highways; but it may, in some cases, assume that duty, and whenever it lawfully does so, the execution of the duty may be enforced against the agents or officers upon whom the law devolves it. It may grant its power to construct a public highway to a corporation or an individual and with that power its right of eminent domain in order to secure the public use; and may make the traffic of the highway common to all on such terms as it may impose. In such case it is its duty to secure that common traffic, when refused, by the authority of its courts. (People v. Collins, 19 Wend. 56; People v. Commissioners of Salem, 1 Cow. 23.) Or it may grant the same powers of construction and maintenance with the exclusive enjoyment of use which the manner of use requires, and if that excludes all common travel and transportation it may impose on the corporation or person the duty to furnish every requisite facility for carrying passengers and freight, and to carry both in such manner and at such times as public needs may require. Why is that duty, in respect of the power to compel its performance through the courts, not in the category of all others intrusted to such a body? The writ of *mandamus* has been awarded to compel a company to operate its road as one continuous line (Union Pacific R. R. Co. v. Hall, 91 U. S. 343); to compel the running of passenger trains to the terminus of the road (State v. H. & N. H. Ry. Co., 29 Conn. 538); to compel the company to make fences and cattle-guards (People, *ex rel.* Garbutt, v. Rochester State Line R. R. Co., 14 Hun 373; s. c., 76 N. Y. 284); to compel it to build a bridge (People, *ex rel.* Kimball, v. B. & A. R. R. Co., 70 N. Y. 569); to compel it to construct its road across streams, so as not to interfere with navigation (State v. N. E. R. R. Co., 9 Richardson 247); to compel it to run daily trains (*In re* New Brunswick, etc., R. R., 1 P. & B. 667); to compel the delivery of grain at a particular elevator (Chicago and

Northwestern R. R. Co. v. People, 56 Ill. 365); to compel the completion of its road (Farmers' Loan and Trust Company v. Henning, 17 Am. Law Reg. [N. S.] 266); to compel the grading of its track so as to make crossings convenient and useful (People, *ex rel.* Green, v. D. & C. R. Co., 58 N. Y. 152; N. Y. C. & H. R. R. Co. v. People, 12 Hun 195; s. c., 74 N. Y. 302; Indianapolis R. R. Co. v. The State, 37 Ind. 489); to compel the re-establishment of an abandoned station (State v. R. R., 37 Conn. 154); to compel the replacement of a track taken up in violation of its charter (Rex v. Severn and Wye Ry. Co., 2 Barn. & Ald. 646); to prevent the abandonment of a road once completed (Talcott v. Pine Grove, *supra*, 1 Flippin 145), and to compel a company to exercise its franchise (People v. A. & V. R. R. Co., 24 N. Y. 261.) These are all express or implied obligations arising from the charters of the railroad companies, but not more so than the duty to carry freight and passengers. That duty is, indeed, the *ultima ratio* of their existence; the great and sole public good for the attainment and accomplishment of which all the other powers and duties are given or imposed. It is strangely illogical to assert that the state, through the courts, may compel the performance of every step necessary to bring a corporation into a condition of readiness to do the very thing for which it is created, but is then powerless to compel the doing of the thing itself.

We can not bring our minds to entertain a doubt that a railroad corporation, is compellable by *mandamus* to exercise its duties as a carrier of freight and passengers; and that the power so to compel it rests equally firmly on the ground that that duty is a public trust, which, having been conferred by the state and accepted by the corporation, may be enforced for the public benefit; and also upon the contract between the corporation and the state, expressed in its charter or implied by the acceptance of the franchise (Abbott v. Johnstown R. Co., 80 N. Y. 31); and also upon the ground that the common right of all the people to travel and carry upon every public highway of the state has been changed in the special instance, by the legislature for adequate reasons, into a corporate franchise, to be exercised solely by a corporate body for the public benefit, to the exclusion of all other persons, whereby it has become the duty of the state to see to it that the franchise so put in trust may be faithfully administered by the trustee.

But it is said that the state is not injured and has no interest in the question whether the corporation perform the duty or not. The state may suffer no direct pecuniary injury, as it may not by the neglect of one or more of its numerous political officers who hold in trust for the people the official duties reposed in their hands; but that is no test of the power or duty of the state in either case. The sovereignty of the state is injured whenever any public function vested by it in any person, natural or artificial, for the common good is not used or is misused, or is abused; and it is not bound to inquire whether some one or more of its citizens has not thereby received a special injury

for which he may recover damages in his private suit. Such an injury wounds the sovereignty of the state and thereby, in a legal sense, injures the entire body politic. The state, in such a case as this, has no other adequate remedy. It may proceed, it is true, to annul the corporation, as has been held in many cases where corporations had neglected public duties. (People v. Fishkill & B. P. R. Co., 27 Barb. 452, 458; People v. H. & C. Turnpike Co., 23 Wend. 254; Turnpike Co. v. State, 3 Wall. 210; People v. K. & M. Turnpike Co., 23 Wend. 208; People v. B. & R. Turnpike Co., 23 Wend. 222; Charles River Bridge Co. v. Warren Bridge, 7 Pick. 344.) But that remedy is not adequate, for it only destroys functions where the public interests require their continued existence and enforcement. It has, therefore, an election which of these remedies to pursue. (State v. H. & N. H. Railroad Co., 29 Conn. 538; People v. A. & V. Railroad Co., 24 N. Y. 261; Talcott v. Pine Grove, *supra*.) \* \* \*

Nor do we think the fact that injured individuals may have private remedies for the damages they have sustained by neglect of duties precludes the state from its remedy by *mandamus*. Where the injury is to a single person under circumstances which do not affect the general public the courts, in the exercise of their discretion, have properly refused this remedy on his relation. The injured party is then the suitor; he has an adequate remedy by private action for damages. That was the case of People, *ex rel.* Ohlen, v. Erie Railway Company (22 Hun 533), relied upon by the court below, in which the court held that the relator's remedy was by suit for damages and not by *mandamus*. That case is not authority for denying the writ to the attorney-general for a neglect or refusal by corporations to exercise their franchises to an extent which affects a great number of citizens, and continues for a considerable period of time; nor does it deny the right of the people acting on their own behalf and in their own suit to pursue this remedy in any case of neglect or refusal to exercise a public function which the interest of the people require should be kept in vigorous and efficient use.

The court, in that case, recognizes the distinction when it says "an exception exists, \* \* \* where a corporation suspends the exercise of its franchises." The suspension of the exercise of corporate functions is the gravamen of the complaint in this case, and the case cited is no authority for denying the writ when the people come into court with their own suit by their attorney-general to move for a writ of *mandamus* on allegations of an alleged long-continued and very general suspension of a corporate duty. \* \* \*

Having determined the question of the right of the state to prosecute the writ of *mandamus* on the ground of refusal or neglect of a corporation to exercise its duty of carrier, it remains to be seen whether a case which would justify the granting of the writ was presented. The case stands altogether upon the facts presented by the appellants. The course taken by the respondents must be regarded as an admission of the material facts contained in the petition and affidavits. \* \* \*

The excuse appears only in the statements of the reasons assigned

by the respondents for their refusal to accept, transport and deliver the freight and property. In the petition it is stated in these words, "that the persons in their employ handling such freight refuse to perform their work unless some small advance, said to be three cents per hour, is paid them by the said railroad corporation." The affidavits show, it may in short be said, that the skilled freight handlers of the respondents, who had been working at the rate of seventeen cents per hour (or one dollar and seventy cents for ten hours), refused to work unless twenty cents per hour, or two dollars per day of ten hours, were paid, and that their abandonment of the work, and the inefficiency of the unskilled men afterwards employed, caused the neglect and refusal complained of. \* \* \*

These facts reduce the question to this: Can railroad corporations refuse or neglect to perform their public duties upon a controversy with their employes over the cost or expense of doing them? We think this question admits of but one answer. The excuse has in law no validity. The duties imposed must be discharged at whatever cost. They can not be laid down or abandoned or suspended without the legally expressed consent of the state. The trusts are active, potential and imperative, and must be executed until lawfully surrendered, otherwise a public highway of great utility is closed or obstructed *without any process recognized by law*. This is something no public officer charged with the same trusts and duties in regard to other public highways can do without subjecting himself to *mandamus* or indictment. \* \* \*

*Reversed.*

See note, *infra*, p. 1318.

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Sec. 421. (b) No specific duty.

SAN ANTONIO STREET RAILWAY CO. v. STATE OF TEXAS.<sup>1</sup>

1897. IN THE SUPREME COURT OF TEXAS. 90 Tex. Rep. 520-528,  
59 Am. St. R. 834.

[Error to court of civil appeals.]

GAINES, C. J. This case arose by a petition filed in the name of the state of Texas upon the relation of Henry Elmendorf and others to compel the plaintiff in error to operate a part of its lines, upon which it had ceased to run its cars. Demurrers to the petition were overruled, and exceptions to the answer of respondent were sustained, and thereupon the peremptory writ was awarded as prayed for in the petition. This judgment was affirmed upon appeal, and to the judgment of affirmance this writ of error has been granted.

The first question is: Did the facts alleged authorize the relief

<sup>1</sup>Part of opinion omitted.

prayed for in the petition? It was alleged that the respondent company was a corporation, chartered by a special act of the legislature passed May 2, 1874, and authorized to operate street railways in the city of San Antonio for the term of fifty years; that it applied to the city council of the city for authority to construct certain lines within the city limits and that the privilege was granted by an ordinance. \* \* \*

It is not expressly averred that at the time the ordinance was passed the company had already constructed and had in operation a line or lines of street railway in the city; but we think that this is to be inferred from section 1, which speaks of the streets over which the privilege to construct and operate was thereby granted as "additional streets and avenues." It was further averred that the company had constructed and for a time had operated the line from its beginning point to Highland Park, but that while it had continued to operate that portion of that line nearest the city, it had abandoned the operation of a part. The prayer was for a writ of *mandamus* to compel the respondent to operate that entire line.

It is a well-settled doctrine that a corporation may be compelled by the writ of *mandamus* to perform a duty imposed by statute. The duty need not be express; it may be implied. Clearly, when it appears by fair implication from the terms of its charter, it is as imperative as if the obligation were expressed. But as to corporations *quasi-public* in character, such for example as those chartered for the carriage of passengers and freight, there are decisions which hold that they owe certain duties to the public which they may be compelled to perform, although not enjoined by their charters, either in express terms or by specific implication. But we have been unable to discover that any well-defined rule has been laid down by the authorities by which we may determine in every case what implied duties are assumed by such a corporation by the acceptance of its charter. It has been held that, in the absence of some direct statutory requirement, a railroad company can not be compelled to establish and maintain a station at a particular point on its line, although it may be shown that the convenience of the public demands it. *Northern Pacific Ry. Co. v. Washington*, 142 U. S. 492; *People v. Railway*, 104 N. Y. 58. A contrary doctrine seems to have been acted upon in *State v. Railway*, 17 Neb. 647, and in *People v. Railway*, 130 Ill. 175. It is one thing to hold that a company, which has accepted a charter authorizing it to construct a line of railroad, with power to condemn property, and has constructed and is maintaining its line, may be compelled to so operate its line as reasonably to meet the necessities of the public; and, as we think, it is quite a different one that a railroad company, by the acceptance of its charter, which simply makes it lawful to construct and maintain a railroad, assumes an obligation to construct it and to maintain its operation so long as its corporate existence may continue.

The latter question was presented in the case of the York and North Midland Railway Company v. The Queen, 1 Ell. & Bl., 858. There the company had constructed its line in part only. The pur-



pose of the suit was to compel it by the writ of *mandamus* to construct the entire road. In the court of Queen's Bench, there was a judgment for the relators—two of the judges concurring in opinion, and one dissenting. This judgment was reversed in the exchequer chamber by the unanimous opinion of the nine judges who sat upon the case. The chief justice, who delivered the opinion of the court upon the hearing of the writ of error, after stating the facts, propounded the questions to be decided as follows: "Upon these facts several points arise: 1. Does the statute of 1849 cast upon the plaintiffs in error a duty to make this railway? 2. If it does not, is there, under the circumstances, a contract between the plaintiffs in error and the land-owners which can be enforced by *mandamus*? 3. And, failing these propositions, does a work which in its inception is permissive only become obligatory by part performance?" The second question does not concern us here. The charter in this case did not involve nor did it grant the taking of private property for the public use. After concluding that there was no language in the statute from which it could be inferred that it was the intention of parliament to make it obligatory upon the company by the acceptance of the charter to construct the entire line of railroad, the court in their opinion decide the first question as follows: "It seems to us, therefore, that these statutes do not cast upon the plaintiff in error this duty, either by express words or by implication; that we ought to adhere to the plain meaning of the words used by the legislature, which are permissive only; and that there is no reason in policy or otherwise why we should endeavor to pervert them from their natural meaning." Upon the third the court speak as follows: "There remains but one further view of the case to be considered; and of that we have partly disposed in the observations which we have already made. But inasmuch as Lord Campbell proceeded upon this ground only in the court below, although it was not much relied upon before us in argument, we have out of respect to his high authority most carefully examined it, and are of opinion that the *mandamus* can not be supported upon the ground that the railway company, having exercised some of its powers, and made part of their line, are bound to make the whole railway authorized by their statutes." The opinion throughout bears the marks of the most careful consideration and is supported, as we think, by argument which can not be satisfactorily answered.

The authorities upon the precise point are but few. But the question arose in the case of *Minnesota v. The Southern Minnesota Railroad Company*, 18 Minn. 40, and the writ of *mandamus* was refused because the statute which authorized the construction of the railroad neither in express terms nor by reasonable construction imposed upon the company the specific legal duty of constructing it. The general principle was also affirmed in the case of *the Northern Pacific Railroad Company v. Washington*, 142 U. S. 492. The attempt in that case was to compel a railroad to establish and maintain a station at a point where it was alleged the interest of the public required such



station. But upon the point decided in that case the decisions are in conflict. \* \* \*

(Citing and commenting upon *State v. Hartford & N. H. R. R. Co.*, 29 Conn. 538; *City v. Railway*, 51 Kan. 609; *People v. Railway*, 24 N. Y. 261.)

The allegations in the petition in this case show that the respondent company was chartered merely for the purpose of constructing and operating street railways in the city. The special act merely gave it the right of corporate existence for the purpose indicated. (*Tugwell v. Eagle Pass Ferry Co.*, 74 Texas 480.) The streets were under the control of the city council. The company could do nothing without the consent of the council. The franchise in question was granted by the city council, and the claim is that it is by virtue of that concession, and its acceptance by the company, that the duty arose. But the ordinance merely grants "the privilege" of constructing and maintaining street railways over the lines therein designated. No clearer words of mere permission could have been employed. Not only this, but there is in the ordinance neither sentence, phrase nor word that indicates that it was the intention of the council to make it a condition of the acceptance of its grant that the company should be bound to construct and operate railways over the streets which were therein specified. The company are required to observe all the ordinances of the city then existing, but it is not averred that there was any ordinance in existence at the time of the acceptance of the franchise which imposed that obligation. \* \* \*

The following succinct and accurate statement of the law from *Redfield on Railways* has been often quoted with approval: "Where the charter of a corporation, or the general statute in force and applicable to the subject, imposes a specific duty, either in terms or by fair and reasonable construction and implication, and there is no specific or adequate remedy, the writ of *mandamus* will be awarded." It is clear that the ordinance in this case neither by express terms nor by implication imposes the duty upon the company. If the duty to construct and maintain the line is to be established, it must be upon the assumption that every privilege granted by a legislative body in reference to matter of public interest imposes upon the grantee who accepts it the duty to perform the acts he is allowed to perform. The assumption, in our opinion, is, as we have already intimated, not based upon sound reason, and is in opposition at least to the weight of authority. \* \* \*

We are of opinion also that the fact that the road has been constructed and operated, and that a part is now operated, makes no difference. Under the grant of a privilege to construct and maintain, if after acceptance it is permissive only to construct, it is not obligatory to maintain. But we do not hold that the company can, against the will of the city, operate a part of its line and not the whole. A privilege to establish an entire line of street railway may be granted when the privilege of constructing and operating a part only would not be; and for a failure to operate a part, it would seem that the whole

might be forfeited. It seems to us that the remedy in this case is to forfeit the franchise to operate the branch line in controversy. The defendant in its answer offers to discontinue the operation of the branch, and apparently this would have been a good answer to the petition if an answer had been necessary. \* \* \*

*Reversed.*

See note, *infra*, p. 1318.

**Sec. 422.** (c) Who may complain.

**RICHMOND RAILWAY AND ELECTRIC CO. v. BROWN.<sup>1</sup>**

1899. IN THE SUPREME COURT OF APPEALS OF VIRGINIA. 97 Va. Rep. 25-37, 32 S. E. Rep. 775.

[Error to judgment of circuit court awarding a *mandamus*, upon the complaint of Brown stating that he was not accorded the rights of a passenger in being transferred from one part of the railway to another without paying an extra fare, as required by the provisions of the agreement with the county court, under legislative authority, permitting an extension of the line and its operation, in the territory where the controversy arose. A demurrer to the petition was filed, which was overruled, and this is assigned as error.] •

HARRISON, J. \* \* \* The first ground of demurrer is that the petition should not have been brought in the name of a private individual, but in the name of some officer authorized to represent the commonwealth. The practice contended for does not obtain in Virginia, and is not sustained by the weight of authority elsewhere. That private persons may move for *mandamus* to enforce a public duty, not due to the government as such, without the intervention of a law officer of the government, is settled by the highest authority. *Railroad Co. v. Hall*, 91 U. S. 355. \* \* \*

The court is further of opinion that the motion to quash the petition was properly overruled. The first ground assigned in support of this motion was that the remedy was complete and adequate at law by a suit for damages. In order that the existence of another remedy shall constitute a bar to relief by *mandamus*, such other remedy must not only be "adequate," in the general sense of the term, but it must be specific and appropriate to the circumstances of the particular case. The remedy at law which will operate as a bar to *mandamus* must generally be such a remedy as will enforce a right or the performance of a duty. A remedy can not be said to be fully adequate to meet the justice and necessities of a case, unless it reaches the end intended, and actually compels a performance of the duty in question. Such other remedy, in order to constitute a bar to *mandamus*, must be adequate to place the injured party, as nearly as the circumstances of the case will permit, in the position which he occu-

<sup>1</sup>Only part of opinion given.

pied before the injury or omission of the duty complained of. The controlling question is not, "Has the party a remedy at law?" but, "Is that remedy fully commensurate with the necessities and rights of the party, under all the circumstances of the particular case?" Or, as was said in one case: "To supersede the remedy by *mandamus*, the party must not only have a specific remedy, but one competent to afford relief upon the very subject-matter of his application, and one which is equally convenient, beneficial and effective as the proceeding by *mandamus*." 2 Spell. Extr. Relief, § 1375.

In the case at bar the *mandamus* was sought to compel the plaintiff in error to transfer the defendant in error from one to another of its street cars without additional charge. If the defendant in error was entitled, as alleged, to the transfer, it is manifest that a suit at law for damages for a failure to perform that duty was not an adequate remedy, and would not actually compel the performance of the duty in question. The wrong suffered was a constantly recurring and continual one, and, whatever may have been the result of repeated suits for damages, the remedy was not as convenient, as beneficial or as effective as the proceeding by *mandamus*.

(After holding that the terms and conditions prescribed by some other designated authority, when so fixed and prescribed become a part of the organic law of the corporation, and can be enforced by *mandamus*, the decision below was affirmed.)

*Note. Mandamus to corporations.*

1. *General principles:*

Whenever a *specific and determined* (1900, Mackin v. Gas Co., 38 Ore. 120, 61 Pac. Rep. 134),

*legal duty* (1799, Runkel v. Winemiller, 4 Harris & McH. (Md.) 429, 1 Am. Dec. 411; 1810, Commonw. v. Rossiter, 2 Binn. (Pa.) 360, 4 Am. Dec. 451; 1855, Union Church v. Sanders, 1 Hous. (Del.) 100, 63 Am. Dec. 187,

is imposed upon a private corporation, expressly or impliedly, either by *statute*, 1819, Rex v. Severn & Wye R. Co., 2 Barn. & Ald. 646, 7 Eng. R. Cas. 445; 1842, Reg. v. Bristol Dock Co., 2 Q. B. 64, 7 Eng. R. Cas. 449; 1853, York N. Mid. Ry. v. The Queen, 1 El. & Bl. 858, 22 L. J. (Q. B.) 225; 1880, Boggs v. R. Co., 54 Iowa 435; 1887, People v. N. Y., etc., R. Co., 104 N. Y. 58; 58 Am. Rep. 484; 1887, O. & M. R. Co. v. People, 120 Ill. 200; 1888, Cummins v. R. Co., 115 Ind. 417; Reg. v. Great W. R. Co., 62 L. J. (Q. B.) 572, 69 L. T. 572; 1896, O., B. & Q. R. v. State, 47 Neb. 549, 53 Am. St. Rep. 557, 41 L. R. A. 481; 1897, San Antonio, etc., Ry. Co. v. State, 90 Texas 520, 59 Am. St. Rep. 834; 1899, People v. Suburban R. Co., 178 Ill. 594, 53 N. E. Rep. 349,

*charter provision*, 1861, State v. Hartford, etc., R. Co., 29 Conn. 538; 1875, Union Pacific R. Co. v. Hall, 91 U. S. 343,

or by the *common law*, 1842, *In re* Trenton Water Power Co., 20 N. J. L. 659; 1861, State v. Hartford, etc., R. Co., 29 Conn. 538; 1873, People v. Chicago, etc., R. Co., 67 Ill. 118; 1873, R. Commrs. v. Portland, etc., R. Co., 63 M. 269, 18 Am. Rep. 208; 1885, State v. Republican Valley R. Co., 17 Neb. 647, 52 Am. R. 424,

and there is no other adequate remedy provided for its enforcement: 1810, Commw. v. Rossiter, 2 Binn. (Pa.) 360; 1877, State v. Mobile, etc., R. Co., 59 Ala. 321; 1881, Lamphere v. Grand Lodge, 47 Mich. 429; 1898, Nebraska Tel. Co. v. State, 55 Neb. 627; 1898, Village of Waverly v. W. & S. R. Co., 35 App. Div. (N. Y.) 38; 1898, *In re* Baldwinville Tel. Co., 24 Misc. (N. Y.) 221;

*mandamus* will lie, in a suit by or on behalf of the state, to enforce the public duty (1887, Crane v. Chicago & N. W. R. Co., 74 Iowa 330, 7 Am. St. Rep. 479, note 484),

or in case of a private right, on behalf of the person to whom the duty is due (1879, *People v. Central, etc.*, R. Co., 41 Mich. 166; 1898, *State v. Spokane St. R. Co.*, 19 Wash. 518, 67 Am. St. Rep. 739; 1900, *Mercur v. Media El. L., etc.*, Co., 7 Del. Co. Rep. 586); but see, 1897, *Baylor v. Pennsylvania Canal Co.*, 183 Pa. St. 167, 63 Am. St. Rep. 749,

but not to enforce a mere optional corporate privilege or to control discretion, 1871, *State v. Canal, etc.*, R. Co., 23 La. Ann. 333; 1887, *People v. N. Y., etc.*, R. Co., 104 N. Y. 58, 58 Am. Rep. 484; 1893, *Florida, etc.*, R. Co. v. *State*, 31 Fla. 482, 34 Am. St. Rep. 30; 1895, *State v. Richards*, 16 Mont. 145, 50 Am. St. Rep. 476; 1896, *State v. Board, etc.*, 134 Mo. 296, 56 Am. St. Rep. 503.

See generally, 1885, *Richardson v. Swift*, 7 Houst. (Del.) 137, 40 Am. St. Rep. 127 (History of the Writ); notes, 89 Am. Dec. 728; 98 Am. Dec. 375; 51 Am. Rep. 78; 3 Am. St. Rep. 807; 7 Am. St. Rep. 484; 37 Am. St. Rep. 317; 59 Am. St. Rep. 198.

## 2. Particular applications:

### (1) As to members.

(a) To compel admission of duly qualified persons: 1865, *People v. Medical Soc.*, 32 N. Y. 187; 1869, *State v. Georgia Med. Soc.*, 38 Ga. 608, 95 Am. Dec. 408, *supra*, p. 136; 1879, *State v. Milwaukee Chamber of Commerce*, 47 Wis. 670. See further note, *supra*, p. 1171, § 354, and note 59 Am. St. Rep. 198.

(b) To restore to membership, when unlawfully deprived, 1875, *People v. N. Y. B. S. of Masons*, 6 Thomp. & Co. 85, 3 Hun 361; 1899, *Weiss v. Mus. Mut., etc.*, Union, 189 Pa. St. 446, 69 Am. St. Rep. 820. See further note, *supra*, p. 1171, § 354.

But see, *contra*, 1855, *Union Church of Africans v. Sanders*, 1 Houst. (Del.) 100, 63 Am. Dec. 487; 1879, *State v. Hebrew Cong., etc.*, 30 La. Ann. 205, 33 Am. Rep. 217; 1883, *Sale v. First Baptist Church*, 62 Iowa 26, 49 Am. Rep. 136.

(c) To compel the calling of meetings, 1875, *State v. Wright*, 10 Nev. 167; 1878, *People v. Cummings*, 72 N. Y. 433.

(d) To compel the transfer of stock, on the books of the company by seller, or purchaser, or by sheriff under execution sale, 1868, *Bailey v. Strohecker*, 38 Ga. 259, 95 Am. Dec. 388; 1883, *State v. First Nat'l Bank of Jeffersonville*, 89 Ind. 302; see, *infra*, § 569.

But see, *contra*, 1872, *Kimball v. Union Water Co.*, 44 Cal. 173, 13 Am. Rep. 157; 1879, *Cushman v. Thayer Mfg. Co.*, 76 N. Y. 365, 32 Am. Rep. 315; 1884, *Treon v. Carriage Co.*, 42 O. S. 31, 51 Am. Rep. 794, note 798; 1886, *Tobey v. Hakes*, 54 Conn. 274, 1 Am. St. Rep. 114.

(e) To compel inspection of books, by members; 1898, *Weihenmayer v. Bitner*, 88 Md. 325, 42 Atl. 245; 1899, *In re Steinway*, 159 N. Y. 250, 45 L. R. A. 461, 53 N. E. Rep. 1103; 1899, *State v. Pacific Br. Co.*, 21 Wash. 451, *infra*, p. 1645; 1900, *In re Journal Pub. Co.*, 30 Misc. (N. Y.) 326, 63 N. Y. S. 465; compare, 1899, *Mathews v. McClaughry*, 83 Ill. App. 224; 1899, *In re Pierson*, 44 App. Div. (N. Y.) 215, 60 N. Y. S. 671; 1900, *People v. Am. Un. L. Ins. Co.*, 31 Misc. (N. Y.) 617, 64 N. Y. S. 916.

See further note, *infra*, p. 1651, § 551.

As to inspecting books of foreign corporations, see, 1885, *Richardson v. Swift*, 7 Houst. (Del.) 137, 40 Am. St. Rep. 127; *infra*, p. 1653; 1898, *Weihenmayer v. Bitner*, 88 Md. 325; 1899, *In re Crosby*, 59 N. Y. S. 340; 1899, *In re Rappleye*, 43 App. Div. (N. Y.) 84, 59 N. Y. S. 338, *infra*, p. 1651.

### (2) As to third parties or the public.

(a) To compel inspection of books by public officers: 1865, *Firemens Ins. Co. v. Mayor, etc.*, 23 Md. 296; 1869, *People v. State Ins. Co.*, 19 Mich. 392; 1898, *State v. Real Estate, etc.*, Assn., 151 Ind. 502, 51 N. E. Rep. 1061; 1899, *State v. Workingmen's, etc.*, Assn., 152 Ind. 278, 53 N. E. Rep. 168.

(b) To pay taxes assessed upon its stock, 1874, *Emory v. State*, 41 Md. 38; 1875, *Barney v. State*, 42 Md. 480; 1885, *Town of St. Albans v. National Car Co.*, 57 Vt. 68.

(c) To enforce religious trusts, 1848, *People v. Steele*, 2 Barb. 397; 1872, *Feisel v. Trustees of First German Soc.*, 9 Kan. 592.

(d) To compel cemetery association to permit burial; 1876, *Mt. Moriah C. A. v. Commw.*, 81 Pa. St. 235, 22 Am. Rep. 743.

(e) To compel gas companies to furnish gas to one complying with requisite conditions, on the same terms as others; 1870, *People v. Manhattan G. L. Co.*, 45 Barb. (N. Y.) 136; 1900, *Mercur v. Media El. L. Co.*, 7 Del. Co. Rep. 586; compare, 1900, *Mackin v. Portland Gas Co.*, 38 Ore. 120, 61 Pac. Rep. 134; 1902, *Snell v. Clinton El. L. Co.*, 196 Ill. 626, 89 Am. St. R. 341.

(f) To compel city water companies to furnish water; 1891, *Haugen v. Albina L., etc., Co.*, 21 Ore. 411; 1895, *Am. Water W. v. State*, 46 Neb. 194, 50 Am. St. Rep. 610; 1899, *People v. Water Co.*, 38 App. Div. (N. Y.) 413; 1893, *State v. Joplin Water-W.*, 52 Mo. App. 312.

(g) To compel an irrigating company to furnish water; 1880, *Price v. Riverside, etc., Irrigating Co.*, 56 Cal. 431; 1887, *Wheeler v. Northern, etc., Co.*, 10 Colo. 582, 3 Am. St. Rep. 603; 1892, *Combs v. Ag. Ditch Co.*, 17 Colo. 146, 31 Am. St. Rep. 275; 1898, *People v. Farmers' High L., etc., Co.*, 54 Pac. Rep. 626.

(h) To compel telephone, telegraph and news gathering companies to furnish service to those complying with reasonable regulations.

1885, *State v. Nebraska T. Co.*, 17 Neb. 126, 52 Am. Rep. 404; 1888, *Central Union Tel. Co. v. State*, 118 Ind. 194, 10 Am. St. Rep. 114; 1888, *Commer. Union Tel. Co. v. N. E. Tel. Co.*, 61 Vt. 241, 15 Am. St. Rep. 893; 1889, *West U. Tel. Co. v. Dubois*, 128 Ill. 248, 15 Am. St. Rep. 109; 1890, *Central Union T. Co. v. State*, 123 Ind. 113; 1898, *Nebraska Tel. Co. v. State*, 55 Neb. 627; 1899, *Cumberland Tel. & T. Co. v. Morgans L. & T. Co.*, 51 La. Ann. 29, 24 So. 803; 1900 *Inter Ocean Pub. Co. v. Associated Press*, 184 Ill. 438, 75 Am. St. Rep. 184. *Contra*, 1881, *American Rap. Tel. Co. v. Conn. Tel. Co.*, 49 Conn. 352, 44 Am. Rep. 237, note 241; 1898, *In re Baldwinsville Tel. Co.*, 24 Misc. (N. Y.) 221, 53 N. Y. S. 574.

(i) To compel ditch, canal, irrigating, or railroad companies to construct and repair bridges, viaducts, farm and street crossings over their ways. 1871, *Indianapolis, etc., R. Co. v. State*, 37 Ind. 489; 1873, *People v. Chicago, etc., R. Co.*, 67 Ill. 118; 1877, *People v. Boston, etc., R. Co.*, 70 N. Y. 569; 1880, *Boggs v. R. Co.*, 54 Ia. 435; 1884, *New Orleans, etc., R. Co. v. Mississippi*, 112 U. S. 12; 1885, *Fresno v. Fowler Sw. C. Co.*, 68 Cal. 359; 1885, *State v. Missouri, etc., R. Co.*, 33 Kan. 176; 1886, *State v. St. Paul, etc., R. Co.*, 35 Minn. 131, 59 Am. Rep. 313; 1888, *State v. Minneapolis, etc., R. Co.*, 39 Minn. 219; 1888, *Cummins v. R. Co.*, 115 Ind. 417, 18 N. E. Rep. 6; 1889, *City of Oskosh v. R. Co.*, 74 Wis. 534, 43 N. W. Rep. 489; 1890, *Commw. v. R. Co.*, 138 Pa. St. 58, 20 Atl. 951; 1891, *State v. C. M. & N. R. Co.*, 79 Wis. 259, 12 L. R. A. 180; 1892, *Moundsville v. Ohio R. Co.*, 37 W. Va. 92; 1892, *State v. Jacksonville St. R.*, 29 Fla. 590; 1896, *C. B. & Q. R. Co. v. State*, 47 Neb. 549, 55 St. 557, 41 L. R. A. 481, s. c. (1898) 170 U. S. 57; 1897, *State v. L. E. & W. R. Co.*, 83 Fed. 284; 1898, *Chicago G. W. R. v. People*, 79 Ill. App. 529; 1898, *State v. R. R. Co.*, 71 Conn. 43.

*Compare*, 1899, *People v. N. Y. C. & H. R. R.*, 158 N. Y. 410, 53 N. E. 166.

(j) To compel a railroad company to build its road according to its charter or articles of association, or the statute under which it is organized. 1819, *Rex v. Severn & Wye R. R. Co.*, 2 Barn. & Ald. 646, 7 Eng. R. Co. 445; 1849, *Cohen v. Wilkinson*, 12 Beav. 125; 1856, *State v. North Eastern R. Co.*, 9 Rich. Law (S. C.) 247, 67 Am. Dec. 551, *supra*, p. 44; 1861, *State v. Hartford, etc., R. Co.*, 29 Conn. 538; 1871, *State v. Southern Minn. R. Co.*, 18 Minn. 40; 1873, *Railroad Commrs. v. Portland, etc., R. Co.*, 63 Me. 269, 18 Am. Rep. 208; 1898, *State v. Spokane St. R. Co.*, 19 Wash. 518, 67 Am. St. Rep. 739; *compare*, 1900, *State v. Cowgill, etc., Co.*, 156 Mo. 620, 57 S. W. Rep. 1008.

See the next paragraph (k).

(k) To compel a railroad company to operate its road according to its charter: 1819, *Rex v. Severn & Wye R. R.*, 2 Barn. & Ald. 646; 1873, *Railroad Commissioners v. Portland, etc., R. Co.*, 63 Maine 269, 18 Am. Rep. 208; 1878, *State v. S., C. & P. R. Co.*, 7 Neb. 357; 1885, *State v. Repub. Valley R. Co.*, 17 Neb. 647; 1893, *City of Potwin Place v. Topeka R. Co.*, 51 Kan. 609, 37 Am.



St. Rep. 312; 1898, *State v. Spokane St. R. Co.*, 19 Wash. 518, 67 Am. St. Rep. 739; 1899, *People v. Suburban R. Co.*, 178 Ill. 594; 1899, *City of Bridgeton v. Bridgeton, etc., Co.*, 62 N. J. Law 592, 43 Atl. Rep. 715; compare, 1890, *People v. Colorado Central R. Co.*, 42 Fed. Rep. 638; *contra*, 1886, *People v. Rome, etc., R. Co.*, 103 N. Y. 95; 1887, *People v. N. Y., L. E. & W. R. Co.*, 104 N. Y. 58, 58 Am. Rep. 484; 1892, *Northern Pac. R. Co. v. Dustan*, 142 U. S. 492; 1895, *State v. Mo. Pac. R.*, 55 Kan. 708, 49 Am. St. Rep. 278; 1897, *San Antonio St. R. v. Texas*, 90 Texas 520, 59 Am. St. Rep. 484.

(1) To compel transportation companies to furnish facilities for transportation without discrimination: 1869, *Commonwealth v. Eastern R. Co.*, 103 Mass. 254; 1870, *Chicago, etc., R. Co. v. People*, 55 Ill. 95, 8 Am. Rep. 631; 1881, *Wells, Fargo & Co. v. Northern Pac. R. Co.*, 23 Fed. Rep. 469, 10 Saw. 441; 1886, *State v. Delaware, etc., R. Co.*, 48 N. J. Law 55, 57 Am. Rep. 543; 1887, *State v. Fremont, etc., R. Co.*, 22 Neb. 313; 1887, *People v. Louisville, etc., R. Co.*, 120 Ill. 48; 1890, *People v. Colorado, etc., R. Co.*, 42 Fed. Rep. 638; 1891, *Cornigton, etc., Co. v. Keith*, 139 U. S. 128; 1893, *Savannah v. Ogeechee C. Co. v. Shuman*, 91 Ga. 400, 44 Am. St. Rep. 43; 1898, *People v. St. L., A. & T. H. Co.*, 176 Ill. 512, 52 N. E. Rep. 292; 1898, *Attorney-General v. Am. Ex. Co.*, 118 Mich. 682, 77 N. W. Rep. 317; 1899, *People v. Suburban R. Co.*, 178 Ill. 594; 1899, *Richmond, etc., R. Co. v. Brown*, 97 Va. 28, 32 S. E. Rep. 775; 1900, *State v. Texas & Pac. R. Co.*, 52 La. Ann. 1850, 28 So. Rep. 284; *contra*, 1886, *People v. Rome, etc., R. Co.*, 103 N. Y. 95; 1887, *People v. N. Y., etc., R. Co.*, 104 N. Y. 58; 1892, *Northern Pac. R. Co. v. Dustan*, 142 U. S. 492; 1895, *State v. Mo. Pac. R. Co.*, 55 Kan. 708, 49 Am. St. Rep. 278; 1897, *Saylor v. Penn. Canal Co.*, 183 Pa. St. 167, 63 Am. St. Rep. 749.

### Sec. 423. (3) Indictment.

See *State v. The N. E. R. R. Co.*, 9 Rich. (S. C.) Law, 247, 67 Am. Dec. 551, *supra*, p. 44.

See, also, Art. II, *supra*, p. 1283, §§ 400-402.

### Sec. 424. B. In courts of equity.

#### (1) Dissolution,—general rule.

#### HUNT, ATTORNEY GENERAL, v. THE LE GRAND ROLLER SKATING RINK COMPANY ET AL.<sup>1</sup>

1892. IN THE SUPREME COURT OF ILLINOIS. 143 Ill. Rep. 118-127.

[Appeal from superior court.]

BAKER, J. This was an information in equity, filed in the superior court of Cook county by the attorney-general, for and in behalf of the people of the state of Illinois, against the Le Grand Roller Skating Rink Company, otherwise called the Le Grand Company, and its stockholders, under section 25 of the corporations act, to dissolve the corporation and obtain a decree declaring the forfeiture of its charter and franchises. The superior court sustained a demurrer to the information, and dismissed the same out of court.

<sup>1</sup> Only part of opinion given.



Two questions are discussed in the briefs and arguments of counsel: First, the right and authority of the attorney-general to file an information in equity under section 25 of the corporations act; and second, the sufficiency of the information here filed to warrant the relief prayed for therein. In the view we have taken of the matter it is necessary to consider only the first of these questions.

All of said section that is material to the present inquiry reads as follows: "If any corporation or its authorized agents shall do or refrain from doing any act which shall subject it to a forfeiture of its charter or corporate powers, or shall allow any execution or decree of any court of record for a payment of money, after demand made by the officer, to be returned 'no property found,' or to remain unsatisfied for not less than ten days after such demand, or shall dissolve or cease doing business, leaving debts unpaid, suits in equity may be brought against all persons who were stockholders at the time, or liable in any way for the debts of the corporation by joining the corporation in such suit, and each stockholder may be required to pay his *pro rata* share of such debts or liabilities to the extent of the unpaid portion of his stock after exhausting the assets of such corporation; and if any stockholder shall not have property enough to satisfy his portion of such debts or liabilities, then the amount shall be divided equally among all the remaining solvent stockholders. And courts of equity shall have full power, on good cause shown, to dissolve or close up the business of any corporation, to appoint a receiver therefor, who shall have authority, by the name of the receiver of such corporation (giving the name), to sue in all courts and do all things necessary to closing up its affairs, as commanded by the decree of such court." \* \* \*

The doctrine of the common law is that a corporation can not be dissolved at the instance of an individual, and that the state, or the attorney-general, as the representative of the state, is a necessary party to any suit to dissolve a corporation for a forfeiture of its charter. But it is entirely competent for the legislative power to provide, by statute, for the absolute and final dissolution of a corporation at a suit of an individual, even though that is no part of the usual or general jurisdiction of either a court of law or a court of chancery. (Folger v. Columbian Ins. Co., 99 Mass. 267; Mickles v. Rochester City Bank, 11 Paige 118, 4 Am. & Eng. Ency. of Law, 304, and authorities cited in note 1.) It is not only the rule that without authority from statute a corporation can not be dissolved at the suit of an individual, but it is also the rule that without statutory authority a court of chancery has no jurisdiction to decree the dissolution of a corporation. \* \* \*

We think it clear that it was the intention of the legislature, by the enactment of said section 25, to afford remedies to creditors of corporations for the enforcement of their private and personal rights, and this even to the extent of permitting courts of equity, for good cause shown, to decree the dissolution of the corporation sued. \* \* \*

There being no power at common law to file this information, and no authority in the statutes unless it can be deduced from said section

25 of the corporations act itself, the question arises whether it was the legislative intention to confer by that section upon the attorney-general power to bring suits in equity to dissolve corporations. No language is used in the section that expresses such intention. The apparent scope of the section is merely to provide remedies to individuals for the enforcement of private and personal rights. The state and the attorney-general already had, and still have, full and adequate remedies at law for the enforcement of forfeitures of corporate charters and franchises and the dissolving of corporations, by writs of *scire facias* and by informations in the nature of *quo warranto*. So there was no occasion for vesting the attorney-general with power to bring suits in equity, unless it was contemplated, as a matter of public policy, to impose upon the state the duty of winding up the affairs of all corporations organized under the corporations act. \* \* \*

In our opinion the superior court was right in its conclusion that the attorney-general is not authorized by law to file a bill or information in equity, under section 25 of the act concerning corporations, for the purpose of dissolving a corporation for a forfeiture of its charter.

The decree is affirmed.

*Note.* As a general rule, in the absence of special statutory authority, courts of equity have no jurisdiction to decree a dissolution of a corporation: 1830, *Society v. Morris Canal Co.*, 1 Saxton (N. J.) 157, 21 Am. Dec. 41; 1831, *Attorney-General v. Stevens*, 1 Saxton Ch. (N. J.) 369, 22 Am. Dec. 526; 1868, *Folger v. Columbia Ins. Co.*, 99 Mass. 268, 96 Am. Dec. 747; 1877, *Thornton v. Marginal Frt. Co.*, 123 Mass. 32; 1878, *Hardon v. Newton*, 14 Blatch. 376; 1879, *Rice v. Nat'l Bank*, 126 Mass. 300; 1880, *Demke v. N. Y. & R. Cement Co.*, 80 N. Y. 599; 1882, *Strong v. McCogg*, 55 Wis. 624; 1882, *Attorney-General v. Aqueduct Corp.*, 133 Mass. 361; 1892, *Wheeler v. Pullman I. & S. Co.*, 143 Ill. 197; 1893, *Repub., etc., Co. v. Brown*, 58 Fed. Rep. 644, 24 L. R. A. 776; 1893, *Mason v. Supreme Court*, 77 Md. 483, 39 Am. St. Rep. 433; 1897, *Wallace v. Pierce W. Pub. Co.*, 101 Iowa 313, 63 Am. St. Rep. 389, 38 L. R. A. 122, *infra*, p. 1747; 1900, *Law v. Rich*, 47 W. Va. 634, 35 S. E. Rep. 858.

See next case.

## Sec. 425. Same. Exception.

### MINER v. THE BELLE ISLE ICE COMPANY, ET AL.<sup>1</sup>

1892. IN THE SUPREME COURT OF MICHIGAN. 93 Mich. Rep. 97-118, 53 N. W. Rep. 218.

[Bill for a receiver, an accounting, and to wind up the affairs of the ice company. In 1874, Miner and Lorman were partners in the ice business, and joint owners of property valued at \$23,500. They concluded to form a corporation, and Miner put in \$1,500 more, and the corporation was formed with a capital stock of \$25,000, 1,000 shares of \$25 each, Miner and Lorman with 435 shares each, I. J. C. 30 shares and L. C. 100 shares. In 1882 some difficulty arose between

<sup>1</sup>Statement abridged; only part of opinion given.

Miner, who looked after filling the ice houses, and Lorman who handled the ice tickets, due bills and cash, each then drawing a salary of \$1,200, and amended articles of association were filed whereby the stock was made \$50,000 of 2,000 shares, with Lorman 1,006, Miner 694, L. C. 259, with seven others holding small sums, three of whom held their stock in trust for Lorman. In 1882, a stockholders' meeting was held, and Lorman, Miner and Linn were elected directors. At the first meeting of the directors in 1882 Lorman and Linn elected Lorman president and general manager at a salary of \$4,000, over the protest of Miner, who left the meeting, and was thereupon discharged from the employ of the company; at subsequent meetings of the directors Lorman was continued at the same salary for seven years, during which time it was shown that only a few annual meetings had been held, and those secretly; that the corporation was wholly controlled by Lorman, that the board did what he told them; that purchases of land were made by the corporation, and then sold for a less sum to Lorman, when there had been no decrease in value; that Lorman leased land worth \$3,500 to the corporation "and for five years thereafter he paid himself in rentals therefor, \$4,650." Much other evidence of fraud was produced.]

McGRATH, J. \* \* \* The only question of difficulty in the case is as to the remedy. There is no doubt of the power of a court of equity, in case of fraud, abuse of trust, or misappropriation of corporation funds, at the instance of a single stockholder, to grant relief, and compel a restitution; and where the holders of the majority of the stock control the directorate, and are themselves the wrongdoers, without any showing that the directors have been requested, or the corporation has refused, to act. *Dodge v. Woolsey*, 18 How. 331; *Pond v. Railroad Co.*, 12 Blatchf. 280; *Brewer v. Boston Theatre*, 104 Mass. 378; *Gregory v. Patchett*, 33 Beav. 595; *Peabody v. Flint*, 6 Allen 52; *March v. Railroad Co.*, 40 N. H. 567; *Mason v. Harris*, 11 Ch. Div. 97; *Atwood v. Merryweather*, L. R. 5 Eq. 464; *Ervin v. Railway Co.*, 27 Fed. Rep. 625; *Allen v. Curtis*, 26 Conn. 456; *Hersey v. Veazie*, 24 Maine 9.

The general rule, undoubtedly is that courts of equity have no power to wind up a corporation in the absence of statutory authority. This rule is, however, subject to qualifications. It has been held that, when it turns out that the purposes for which a corporation was formed can not be attained, it is the duty of the company to wind up its affairs; that the ultimate object of every ordinary trading corporation is the pecuniary gain of its stockholders; that it is for this purpose, and no other, that the capital has been advanced, and if circumstances have rendered it impossible to continue to carry out the purpose for which it was formed with profit to its stockholders, it is the duty of its managing agents to wind up its affairs. To continue the business of the company under such circumstances would involve both an unauthorized exercise of the corporate franchises and a breach of the charter contract. *Mor. Corp.*, §§ 217, 407. The rule applicable in cases of a copartnership has been held to apply in case of a corpora-

tion or joint-stock company. *In re Suburban Hotel Co.*, L. R. 2 Ch. App. 737. In that case Lord Cairns says:

"If it were shown to the court that the whole substratum of the partnership, the whole of the business which the company was incorporated to carry on, has become impossible, I apprehend the court might, either under the act of parliament or on general principles, order the company to be wound up. But what I am prepared to hold is this: That this court, and the winding-up process of the court, can not be used as the means of evoking a judicial decision as to the probable success or non-success of a company as a commercial speculation."

In the present case, we have a corporation that for seven years has not paid a dividend. Complainant has had invested and tied up nearly \$18,000. The only reason why it has failed to pay dividends, for part of the time at least, is because defendant Lorman, owning a majority of the stock, has controlled the corporation in his own interest and profit. Is a court of equity powerless to give an adequate remedy because the failure to pay dividends is not attributable to natural causes, but by reason of gross frauds perpetrated by the management? Would the court hesitate an instant in case this were a copartnership? \* \* \*

(Citing and quoting from *Ervin v. Railway Co.*, 27 Fed. Rep. 625, 630; *Dodge v. Woolsey*, 18 How. 331.)

In *Wallworth v. Holt*, 4 Mylne & Co. 635, Lord Cottenham says:

"I think it is the duty of this court to adapt its practice and course of proceeding to the existing state of society, and not, by too strict an adherence to rules and forms established under different circumstances, to decline to administer justice, and to enforce rights for which there is no other remedy."

Sir James Wigram, in *Foss v. Harbottle*, 2 Hare 491, says:

"Corporations of this kind are in truth little more than private partnerships; and in cases which may be easily suggested it would be too much to hold that a society of private persons associated together in undertakings which, though certainly beneficial to the public, are nevertheless matters of private property, are to be deprived of their civil rights *inter se*, because, in order to make their common objects more attainable, the crown or legislature have conferred upon them the benefit of a corporate character."

In *Bacon v. Robertson*, 18 How. 480, which was a proceeding to compel the trustees to distribute among the stockholders the effects of a corporation whose charter had been forfeited, there is an able discussion by Campbell, J., of the powers of courts of equity relating to corporations. Campbell, J., referring to the cases just cited, says:

"These just views which have afforded to wise chancellors a sufficient motive to enlarge the scope and relax the vigor of the rules of chancery proceedings, so as to bring the civil rights of individuals, in whatever form they may exist, or however complicated or ramified, under the protection of legitimate judicial administration, have been

adopted in the United States, not simply for the improvement of methods of proceeding, but also for the adjustment of rights and the assertion of responsibilities among the members of such associations."

The present case furnishes an instance of gross abuse of trust. Must the *cestui que trust* be committed to the domination of a trustee who has for seven years continued to violate the trust? The law requires of the majority the utmost good faith in the control and management of the corporation as to the minority. It is of the essence of this trust that it shall be so managed as to produce for each stockholder the best possible return for his investment. The trustee has so far absorbed all returns. What is the outlook for the future? This court, in view of the past, can give no assurances. It can make no order that can prevent some other method of bleeding this corporation, if it is allowed to continue. If Lorman be removed, who shall take his place? He has the absolute power to determine. Once deposed he may elect a dummy to fill his place. There are practically but three persons concerned, Miner, Lorman and Lorissa Carpenter, and she has for seven years, in fraud of complainant's rights, been paid a dividend to secure her acquiescence. Who has any right to complain if ample and complete justice is awarded to Miner? Who should be permitted to stand between him and an adequate remedy? This corporation has utterly failed of its purpose, not because of matters beyond its control, but because of fraudulent mismanagement and misappropriation of its funds. Complainant has a right to insist that it shall not continue as a cloak for a fraud upon him, and shall not longer retain his capital to be used for the sole advantage of the owner of the majority of the stock, and a court of equity will not so far tolerate such a manifest violation of the rules of natural justice as to deny him the relief to which his situation entitles him.

I think a court of equity, under the circumstances of this case, in the exercise of its general equity jurisdiction, has the power to grant to this complainant ample relief, even to the dissolution of the trust relations. Complainant is therefore entitled to the relief prayed. A receiver will be appointed, and the affairs of this corporation wound up. Defendant Lorman must account, and pay over all moneys illegally received by him, paid to him, or paid out by him from the funds of the corporation. \* \* \*

*Decree accordingly.* See note, 91 Am. St. R. 33.

## Sec. 426. (2) Injunction.

### ATTORNEY-GENERAL V. TUDOR ICE COMPANY.<sup>1</sup>

1870. IN THE SUPREME JUDICIAL COURT OF MASSACHUSETTS.  
104 Mass. Rep. 239-244, 6 Am. Rep. 227.

[Information in equity by the attorney-general on behalf of the state to restrain defendants from engaging in various lines of business. The company was organized in 1861, for purpose of "cutting, storing

<sup>1</sup> Statement abridged.

and selling ice," with a capital stock of \$360,000. It engaged in this business, and also chartering vessels and shipping ice to East Indies, along with kerosene, tobacco, rosin and lumber; purchased and imported paddy, jute, linseed and tea; also, engaged in manufacture of tobacco, gunny cloth, linseed oil, etc.; the capital invested in such manufacture being three or four times larger than its capital stock; this business has been profitable but unnecessary. No creditors are in danger of loss, and no objection is made except that these lines are unauthorized, and alleged to be against public policy.]

GRAY, J. This court, sitting in equity, does not administer punishment or enforce forfeitures for transgressions of law; but its jurisdiction is limited to the protection of civil rights, and to cases in which full and adequate relief can not be had on the common-law side of this court or of the other courts of the commonwealth.

The Tudor Ice Company is a private trading corporation. It is not in any sense a trustee for public purposes. This is not a suit by a stockholder or a creditor. The acts complained of are not shown to have injured or endangered any rights of the public, or of any individual or other corporation; and can not, upon any legal construction, be held to constitute a nuisance. It is expressly stated, in the report of the chief justice, that "it does not appear that any of the creditors of the company are in danger of losing by it, and there is no objection to its proceedings, except that they are not authorized by its act of incorporation and are alleged to be against public policy for that reason." No case is therefore made upon which, according to the principles of equity jurisprudence and the practice of this court, an injunction should be issued upon an information in chancery.

In *Attorney-General v. Utica Insurance Co.*, 2 Johns. Ch. 371, Chancellor Kent, in a very able and elaborate judgment, after a thorough discussion of the question on principle, and an extensive examination of the earlier authorities, held that such an information could not be maintained to restrain an insurance company from exercising banking powers in violation of a statute of New York, but that the proper remedy was at law, by information in the nature of a *quo warranto*, and no appeal appears to have been taken from his decree. An information in the nature of a *quo warranto* was thereupon filed, and sustained by the supreme court of New York, and judgment rendered thereon that the corporation be ousted from the franchise which it had usurped. *People v. Utica Insurance Company*, 15 Johns. 358. Similar proceedings may be had at law in this commonwealth in a proper case. *Goddard v. Smithett*, 3 Gray 116, 122, 123. *Attorney-General v. Salem*, 103 Mass. 138; *Boston and Providence Railroad Co. v. Midland Railroad Co.*, 1 Gray 340; Gen. Sts., ch. 145, §§ 16-24.

One early English case of high authority, not cited by Chancellor Kent, nor at the argument of the present case, is so much in point as to be worth quoting in full. Upon a bill in equity, filed by the attorney-general, at the relation of several freemen of the Weavers' Company, against the officers of that company, setting forth "that the defendants had been guilty of many breaches and violations of their



charters, and had oppressed the freemen, etc., and mentioned some particulars, and for a discovery of the rest, and that they might be decreed for the future to observe the charters, and to have an account of the revenue of the corporation which the defendants had misspent, etc., was the end of the bill. To which the defendants demurred, because, as to part of the bill, it was to subject them to prosecutions at law, and to a *quo warranto*; and as to the other parts, the plaintiffs had remedy by *mandamus*, information or otherwise, and not here. And of the same opinion," the report proceeds, was Lord Cowper, "who said it would usurp too much on the king's bench, and that he never heard of any precedent for such a case as this, and so allowed the demurrer." *Attorney-General v. Reynolds*, 1 Eq. Cas. Ab. (3d ed.) 131.

The modern English cases, cited in support of this information, were of suits against public bodies or officers exceeding the powers conferred upon them by law, or against corporations vested with the powers of eminent domain and doing acts which were deemed inconsistent with rights of the public.

Some of them were cases of misapplication of funds raised by taxation and held by municipal corporations or officers upon specific public trusts. Such were *Attorney-General v. Norwich*, 16 Sim. 225, *Attorney-General v. Guardians of Poor of Southampton*, 17 Sim. 6, and *Attorney-General v. Andrews*, 2 Macn. & Gord. 225.

The hypothetical case, in which Lord Westbury, in *Stockport District Waterworks v. Manchester*, 9 Jur. (N. S.) 266, said that he should "probably not hesitate" to act upon the information of the attorney-general, was of a suit to restrain the making of a contract between an aqueduct corporation and a city to carry water beyond the limits which the city was authorized by law to supply.

The passages cited from *Liverpool v. Chorley Water Works Co.*, 2 De Gex, Macn. & Gord. 852, 860, and *Ware v. Regent's Canal Co.*, 3 De Gex & Jones 212, 228, were but *dicta* that an unauthorized diversion of water or flowing of land by an aqueduct or canal corporation, without proof of actual or imminent injury to property, gave no right of suit to an individual, and could only be checked on an application to the court by the attorney-general.

The case of *Attorney-General v. Great Northern Railway Co.*, 4 De Gex & Smale 75, was a clear case of nuisance, the unlawful obstruction of a public highway by a railroad. That of *Attorney-General v. Oxford, Worcester and Wolverhampton Railway Co.*, 2 Weekly Rep. 330, was the case of the opening of a railway line in violation of an order which an authorized public board had made upon the ground that it would be unsafe to the public.

The single case, in which an information has been sustained in an English court of chancery against a corporation for carrying on a business beyond its corporate powers, is *Attorney-General v. Great Northern Railway Co.*, 1 Drewry & Smale 154, in which Vice-Chancellor Kindersley in 1860 restrained a railway company from trading in coal in large quantities, upon the ground that there was danger

that, if allowed to go on, it might get into its hands the coal trade of the whole district from or through which its railway ran, and thus acquire a monopoly injurious to the public. That case is evidently the foundation of the *dictum* of Vice-Chancellor Wood, two years later, in *Hare v. London and Northwestern Railway Co.*, 2 Johns. & Hem. 80, 111.

In *Attorney-General v. Mid Kent Railway Co.*, Law Rep. 3 Ch. 100, a mandatory injunction was granted upon the information of the attorney-general to compel a railway company to construct a bridge over a public road, and with as gradual a slope as was required by a special clause in its charter; and the objection that the attorney-general might have had an equal and complete remedy at law was stated by each of the lords justices as if it required no answer and afforded no ground for refusing to entertain jurisdiction in equity. It is often said, in the English books, that the king or his attorney-general, suing in behalf of the public, has the election to sue in either of his courts, and may therefore enforce a legal right in the court of chancery. 1 Dan. Ch. Pract. (3d Am. Ed.) 6, 7; *Attorney-General v. Galway*, 1 Molloy 95, 103. However that may be, by our statutes the general equity jurisdiction of this court is limited to cases where there is no plain, adequate and complete remedy at law, as well in suits by the commonwealth as in those brought by private persons. Gen. Sts., ch. 113, § 2; *Commonwealth v. Smith*, 10 Allen 448; *Clouston v. Shearer*, 99 Mass. 209, 211, and other cases there cited. The 38th of the former rules in chancery of this court (14 Gray 360) by which the court adopted, as the outlines of its practice, the practice of the high court of chancery in England, so far as the same was not repugnant to the constitution and laws of the commonwealth, nor to those or such other rules as the court might from time to time make, can not enlarge the jurisdiction of this court as defined by statute, and has been repealed by the new rules recently established. Rules of 1870, *post*, 104 Mass. 555.

The only cases in which informations in equity in the name of the attorney-general have been sustained by this court are of two classes. The one is of public nuisances, which affect or endanger the public safety or convenience, and require immediate judicial interposition, like obstructions of highways or navigable waters. *District Attorney v. Lynn and Boston Railroad Co.*, 16 Gray 242; *Attorney-General v. Cambridge*, 16 Gray 247; *Attorney-General v. Boston Wharf Co.*, 12 Gray 553; *Rowe v. Granite Bridge Co.*, 21 Pick. 344, 347. The other is of trusts for charitable purposes, where the beneficiaries are so numerous and indefinite that the breach of trust can not be effectively redressed except by suit in behalf of the public. *County Attorney v. May*, 5 Cush. 336; *Jackson v. Phillips*, 14 Allen 539, 579; *Attorney-General v. Garrison*, 101 Mass. 223; Gen. Sts., ch. 14, § 20. If there are any other cases to which this form of remedy is appropriate, that of a private trading corporation, whose proceedings are not shown to have injured or endangered any public or

private rights, and are objected to solely upon the ground that they are not authorized by its act of incorporation and are therefore against public policy, is not one of them.

*Information dismissed.*

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**Sec. 427. Same.**

THE STATE OF KANSAS, EX REL. J. B. NAYLOR, v. THE DODGE CITY, MONTEZUMA AND TRINIDAD RAILWAY COMPANY.

1894. IN THE SUPREME COURT OF KANSAS. 53 Kan. Rep. 377-379, 42 Am. St. Rep. 295.

ALLEN, J. This action was instituted by the county attorney of Gray county, in the name of the state, to restrain the defendant from tearing up and removing the track, ties and iron from that part of the road-bed of the Dodge City, Montezuma and Trinidad Railroad in Gray county. A restraining order was granted by the district judge, to continue in force until December 22, 1893, which time was fixed for hearing the application for a temporary injunction. A hearing was had at that time, and the temporary injunction was denied. The plaintiff brings the case here for review.

While the title to a completed railroad is vested in the corporation, it is only private property in a qualified sense. Railroads, like all other public thoroughfares, are public instrumentalities. The power to construct and maintain railroads is granted to corporations for a public purpose. The right to exercise the very high attributes of sovereignty, the power of eminent domain and of taxation, to further the construction of railways, could not be granted to aid a purely private enterprise. The railway corporation takes its franchises subject to the burden of a duty to the public to carry out the purposes of the charter. The road, when constructed, becomes a public instrumentality, and the road-bed, superstructure and other permanent property of the corporation are devoted to the public use. From this use neither the corporation itself, nor any person, company or corporation deriving its title by purchase, either at voluntary or judicial sale, can divert it without the assent of the state. It matters not whether the enterprise as an investment be profitable or unprofitable, the property may not be destroyed without the sanction of that authority which brought it into existence. Without legislative sanction, railroads could not be constructed. When once constructed, they may only be destroyed with the sanction of the state. The legislature unquestionably has the power to authorize the abandonment of railroads when they cease to be of public utility. It may be, also, that in an action prosecuted by the attorney-general, on behalf of the state, to forfeit the charter and wind up the affairs of a railroad corporation, for any proper cause, the court might make all necessary orders for the disposition of the property of the company; but in this case the state appeared, by the county

attorney of the county in which the road was located, protesting against the removal of the superstructure of the road. The court erred in refusing the injunction asked.

The general propositions stated above are abundantly supported by authority: *E. & N. E. R. Co. v. Casey*, 26 Pa. 287; *The State v. S. C. & T. R. Co.*, 7 Neb. 357; *People v. L. & N. R. Co.*, 10 N. E. Rep. (Ill.) 657; *Railroad Com'rs v. P. & O. C. R. Co.*, 63 Maine 269; *Railway Co. v. Mining Co.*, 68 Ill. 489; *Gates v. Railroad Co.*, 53 Conn. 333; *Thomas v. Railroad Co.*, 101 U. S. 71; *Railroad Co. v. Winans*, 17 How. 30; *Pierce v. Emery*, 32 N. H. 484; *People v. N. Y. C. & H. R. R. Co.*, 28 Hun 543.

These views are also in accordance with prior decisions of this court: *Com'rs of Leavenworth Co. v. Miller*, 7 Kan. 479; *St. J. & D. C. R. Co. v. Ryan*, 11 Kan. 603; *The State, ex rel., v. Bridge Co.*, 22 Kan. 438; *City of Potwin Place v. Topeka R. Co.*, 51 Kan. 609.

We have decided this case on what appears in the record, without reference to facts developed on the hearing of other cases relating to the same railroad company, which may deprive the plaintiff of any substantial benefit from the decision in this case. The order of the district court, refusing the temporary injunction, is reversed.

All the justices concurring.

*Note.* An injunction may be granted upon the application of the state, whenever a corporation is abusing the powers given to it for a public purpose, or acting adversely to the public, or creating a nuisance, or threatening to do any of these. 1829, *In re Binney*, 2 Bland (Md.) 99; 1860, *Attorney-General v. Great Northern R. Co.*, 1 Drew & Sm. 154; 1873, *State v. County Court*, 51 Mo. 350, 11 Am. Rep. 454; 1874, *Attorney-General v. Chicago & N. W. Ry. Co.*, 35 Wis. 425; 1875, *Appeal of Edgewood R. Co.*, 79 Pa. St. 257; 1882, *Attorney-General v. Aqueduct Corp.*, 133 Mass. 361; 1895, *Chicago Fair Grounds Assn. v. People*, 60 Ill. 488; 1895, *Columbia Athletic Club v. State*, 143 Ind. 98, 52 Am. St. Rep. 407; 1901, *State v. Schlitz Brewing Co.*, 104 Tenn. 55.

So too, a private party that will be injuriously affected may have an injunction, if damages would be an inadequate remedy. 1832, *Scudder v. Trenton*, etc., *Falls Co.*, 1 N. J. Eq. 694, 23 Am. Dec. 756; 1852, *Christopher v. City of New York*, 13 Barb. (N. Y.) 569; 1860, *West Md. R. Co. v. Owings*, 15 Md. 199, 74 Am. Dec. 563; 1869, *Mayor v. Groshon*, 30 Md. 436, 96 Am. Dec. 591; 1875, *Ottawa, O. & F., etc., R. Co. v. Black*, 79 Ill. 262; 1887, *Iron Age Pub. Co. v. W. U. Tel. Co.*, 83 Ala. 498, 3 Am. St. 758; 1895, *Bienville Water Supply v. Mobile*, 112 Ala. 260, 57 Am. St. Rep. 28; 1899, *Harding v. Am. Glucose Co.*, 182 Ill. 551, 74 Am. St. R. 189; 1900, *Inter Ocean Pub. Co. v. Assoc. Press*, 184 Ill. 438, 75 Am. St. Rep. 184. *Contra*, 1865, *Buck Mountain Coal Co. v. Lehigh Coal Co.*, 50 Pa. St. 91, 88 Am. Dec. 534.

It seems, too, that the state can complain and prevent the dissipation of the funds of a public charitable trust when the beneficiaries are so numerous and indefinite that the trust can not be effectively protected, except through the public authorities. *Clark Corp.*, § 84, p. 247; citing *Parker v. May*, 5 Cush. (Mass.) 336; *Jackson v. Phillips*, 14 Allen (Mass.) 539; *Attorney-General v. Garrison*, 101 Mass. 223.

A single shareholder may enjoin the acceptance of fundamental changes in the corporate constitution, the diversion of the corporate funds, or the consummation of executory *ultra vires* transactions. 1853, *Kean v. Johnson*, 9 N. J. Eq. 401; 1855, *Dodge v. Woolsey*, 18 How. (U. S.) 331, *supra*, p. 88; 1856, *Sears v. Hotchkiss*, 25 Conn. 171, 65 Am. Dec. 557; 1858, *Bliss v. Anderson*, 31 Ala. 612, 70 Am. Dec. 511; 1860, *March v. Eastern R. Co.*, 40 N.

H. 548, 77 Am. Dec. 732; 1861, Abbott v. Hard Rubber Co., 33 Barb. 578; 1867, Zabriskie v. Hackensack, etc., R. Co., 18 N. J. Eq. 178, 90 Am. Dec. 617, *infra*, p. 1466.

1890, Gamble v. Queens Co. Water Co., 123 N. Y. 91, 9 L. R. A. 527, 31 Am. & Eng. C. C. 313; 1896, Green v. Hedenberg, 159 Ill. 489, 50 Am. St. Rep. 178; 1899, Harding v. Am. Glucose Co., 182 Ill. 551, 74 Am. St. Rep. 189. See *infra*, Shareholder and corporation, §§ 513, 585.

## ARTICLE II. VISITATION OF CORPORATIONS.

### Sec. 428. 1. Private visitor.

#### SMYTH v. VISITORS OF THE THEOLOGICAL INSTITUTION IN PHILLIPS ACADEMY IN ANDOVER.<sup>1</sup>

#### TRUSTEES OF PHILLIPS ACADEMY v. ATTORNEY-GENERAL ET AL.

1891. IN THE SUPREME JUDICIAL COURT OF MASSACHUSETTS.  
154 Mass. Rep. 551-569.

[Appeal by Smyth from decree of visitors, dismissing him from a professorship, and bill in equity by trustees against visitors, for instructions as to effect and validity of the decree dismissing professors. In 1778 Phillips Academy to instruct youth in the common branches of learning was founded, and in 1780, its board of trustees were incorporated, and with their successors were to "be the true and sole visitors, trustees and governors of said Phillips Academy, in perpetual succession forever." By an act of 1807, the corporation was authorized to hold other real and personal property, the income to be applied to the purposes of a theological institution "agreeably to the will of the donors." Gifts for this purpose were accordingly made to the corporation, in which, by the consent of the trustees, visitorial powers were reserved whereby "every founder of a professorship \* \* \* will have the exclusive right of prescribing the regulations and statutes to be observed by the trustees in conducting the concerns of the same (consistent with the objects of the institution) with the right, for the term of his life, of appointing \* \* \* such local visitor as he may think proper, and endow him with all visitorial power necessary, etc." In 1808, the various donors and the trustees agreed to "*Associate Statutes*" whereby all the control and management of the theological institution was left to the trustees who hold the property, subject to a visitorial power in a *board of visitors*, created by these associate statutes, giving authority, among other things "to take care that the duties of every professor \* \* \* be intelligibly and faithfully discharged, and to admonish or remove him either for misbehavior, heterodoxy, incapacity, or neglect of the duties of his office." In 1823, this board of visitors was incorporated, with the powers given

<sup>1</sup> Statement abridged; part of opinion of Knowlton, J., and all of dissenting opinion of Field, C. J., omitted.



in the Associate Statutes. At the hearing before the visitors that resulted in the removal of Smyth and four other professors, the trustees applied for leave to be heard, but were refused.]

KNOWLTON, J. \* \* \* The nature of the duties of visitors of educational or charitable institutions is to some extent implied in the name which these officers bear. They are to visit the corporation. They are to go where it is, and see it and its representatives face to face. 2 Kent Com. (13th ed.) 302. The King v. Bishop of Ely, 1 Wm. Bl. 71, 82; Eden v. Foster, 2 P. Wms. 325. Their visitation is for the purpose of inquiring into its condition, and ascertaining whether it is properly or improperly managed, and whether in all respects it is conducted according to the principles of its foundation. A visitation may be general or special; and under most English foundations, to protect the managing board from too frequent interference, a general visitation can only take place at the expiration of a certain interval, as one, three, five or ten years. Following this theory, the Andover statutes prescribe that general visitations shall be once in a year. Associate Statutes, art. 20. A special visitation may be made at any time at the request of the governing body, or of any one claiming a grievance against it, and who on that account has a right to promote the office of the visitors. When special duties are imposed on the board of visitors by the founder, the visitors may perform them at such times as required by the statutes which confer their authority. Ordinarily at a special visitation the managing body of the institution is necessarily a formal party before the visitors, because the visitation proceeds on a formal application by the managers, or by some one asking relief against them. When questions arise at a general visitation, whatever the form of the proceedings, the real party whose conduct is on trial is the managing board, by reason of whose act or omission the institution is alleged to have gone astray. Although the visitors are not a court, in the performance of some of their duties they act judicially, and they must be governed by the will of the founder as expressed in his statutes. It is a fundamental principle of all judicial proceedings that one whose conduct is called in question shall be heard in his defense, and this principle is as important in its application to the managing board of a charitable corporation whose acts or omissions are under investigation by a board of visitors as to an individual charged with the commission of a crime. Murdock, Appellant, 7 Pick. 303; Murdock v. Phillips Academy, 12 Pick. 244. It is inconceivable that a board of visitors intending to be governed by principles of justice should for a moment think of refusing the managing body a hearing in a case where the proceedings are directly against it to set aside its action. But it should not be forgotten that almost everything which comes within the jurisdiction of a board of visitors acting under their general visitatorial power involves a trial of the managing board, and the jurisdiction of the visitors to deal with the agents or servants or individual beneficiaries of the institution is, ordinarily, merely incidental to their jurisdiction over the institution itself



as represented by its managing officers. If by the statutes they are given express authority to act in a visitatorial capacity in regard to an agent, their action may no less directly affect the institution itself. The form of the proceedings is immaterial; if the visitors are in fact seeking to revise the action of the managers by virtue of their supervisory power, the managers should have an opportunity to be heard.

So far as the industry of the counsel on either side has furnished us with authorities, we have found nothing to indicate that visitations of educational or charitable institutions, under foundations like that which we are considering, have ever been had without notice to the managing board. In some relations, under the ecclesiastical system in England, the bishop has visitatorial power of a different kind, which we need not consider; but in institutions like the theological department of Phillips Academy the right of the managing board to be heard before the visitors in every proceeding affecting the corporation seems to have been always assumed. In *The King v. Bishop of Ely*, 2 T. R. 290, 336, 338, 345, in considering the question whether a visitor acted in his official capacity, Ashhurst, J., said: "But even supposing that this matter was within the bishop's visitatorial authority, yet he has not acted in the character of a visitor. The exercise of a visitor's power, in a case like the present, is a judicial act, and a judge can not determine without hearing the parties concerned. So that even if he had the right to exercise such a power, he should have done it in a formal manner, and should at least have convened the parties interested to give them an opportunity of making a defense." Buller, J., used the following language: "His proceedings, therefore, have not even the show of a visitation, for whenever that is intended the parties whose conduct or whose rights are objected to should be heard, or at least convened before him, and have an opportunity of being heard, but in the present instance this ceremony was totally omitted." Grose, J., said: "Neither did he himself conceive that he was acting as visitor; his acts show that he was not; and he acted without giving notice to the persons on whom he was judging." Not only is this language applicable in terms to the governing board of a corporation whose conduct is called in question, but the facts of that case show that the judges had reference to the governing board of Peterhouse College, to whose action the controversy related. In those cases under royal charters, where the visitatorial power is in the king, visitatorial proceedings in regard to the management of the affairs of the corporation have been conducted before the lord chancellor, who has observed the same rules as to bringing before him all parties interested as in ordinary cases in chancery; and every reason that exists in any case why parties interested in a proceeding should have a right to be heard applies in cases like the present.

The counsel for the trustees asserted at the argument that it had been the universal practice in England for visitors to give notice and an opportunity of being heard to the managing body before making a decree affecting the management of an eleemosynary institution, and they offered to present affidavits showing the result of extended re-

searches in regard to the subject; but, the respondents objecting, and the facts not being regularly before us as evidence, we have considered only such cases as appear in the reports or come within general historical knowledge. These indicate that the practice in England has been as contended by the trustees. *Philips v. Bury*, 2 T. R. 346; s. c. 1 *Ld. Raym.* 5; *The King v. Bishop of Ely*, 2 T. R. 290; *Attorney-General v. Dixie*, 13 Ves. 519; *Attorney-General v. Earl of Clarendon*, 17 Ves. 491.

It can not be maintained that the visitors are the corporation that holds the property and is primarily responsible for the affairs of the seminary, or that they sufficiently represent the corporation when sitting as judges. They are incorporated as a separate board, and are the judicial department of the theological institution. They are not supposed to be familiar with the details of the business of the principal corporation, nor to understand the practical effect of many things in its management. They do not represent the corporation as an administrative board, and at a hearing in regard to the management of its affairs they would ordinarily need the aid of facts, suggestions, and arguments which the managers alone could properly present. Besides, while they act as judges, they are not in a position to defend ardently and vigorously acts of the corporation which might be unjustly and vigorously attacked by others.

It is a mistake to treat a proceeding before the visitors to remove five of the professors of an institution like the theological seminary at Andover as a suit against the professors alone. If they are wrongly there, the trustees should have removed them. The proceedings look to a change which would be likely to concern very deeply the interests of the seminary. Can it be said that the officers of the corporation who have been charged with its management in the past, and who will be held responsible for its conditions in the future, are not interested in a matter so vitally affecting it? \* \* \*

In the present case the trustees were not heard before the visitors, although they made a formal application for leave to become a party at the trial. The action of the visitors in this particular is subject to revision by the justices of this court, who are expressly given authority, under article 25 of the associate statutes, to set aside any decree which they deem contrary to the statutes, or beyond the just limits of the power of the visitors. By article 20 the visitors are required to administer justice impartially, and exercise the functions of their office "according to the said statutes, the constitution of this seminary, and the laws of the land." We do not intimate that visitors, in determining questions before them, are to be held to all the rules and formalities which would be observed by a court of law under similar circumstances, nor that their action can ordinarily be revised by a court in the absence of an express provision to that effect in the statutes, unless it so affects a charity that a court of equity ought to interfere under its jurisdiction for the protection of trusts. But where a principle essential to a fair and proper adjudication of the rights of

parties is disregarded in deciding a question, their action under statutes like those before us is invalid. \* \* \*

For these reasons we are of opinion that the action of the visitors was not in accordance with the statutes which they were trying to maintain, and that their decree must be set aside. \* \* \*

*Decree accordingly.*

*Note.* Visitation of corporations: Blackstone says: "As to eleemosynary corporations, by the dotation the founder and his heirs are of common right the legal visitors to see that such property is rightly employed, as might otherwise have descended to the visitor himself, but, if the founder has appointed and assigned any other person to be visitor, then his assignee so appointed is invested with all the founder's power in exclusion of his heir." 1 Comm., p. \*482. The visitor had exclusive jurisdiction to control according to the statutes or trusts upon which the corporation was founded, and his judgments, if they were not in excess of these, were not reviewable by the courts. So, too, the visitor has no authority to modify, or accept any material amendments in the statutes of the original foundation, without consent of the beneficiaries. At common law, where the rules of primogeniture obtained, there was but little inconvenience resulting, in case the donor did not appoint a visitor—for the rules of descent would carry the right to the eldest son as in other cases. In this country, after a few descents are cast the heirs are likely to become so numerous that great inconvenience, if not an impossibility of properly controlling such corporations in this way, results. While it is usual to say that, in the absence of any other provision, the common-law rules of visitation apply, yet there is some question as to this rule of the common law being applicable to our condition. In any event, the statutes, or the provisions of the foundation, usually designate some one to be selected as a visitor by some public authority, such as the court where the corporation is to be located, or the council of the municipality, etc. And it seems that if the trustees of the corporation created to manage the property generally are clothed with "all the powers of management," their power will include that of the visitors; but in such case the state through its courts would undoubtedly have the powers of control through *quo warranto*, or similar proceedings, as it has in civil corporations generally. Most of the learning relating to the visitation of corporations by private visitors is to be found in the following cases: 1694, Phillips v. Bury, 1 Ld. Raym 5; 4 Mod. 106; Show., 85; Skinn., 407; Salk., 408; Carth., 180; 1815, Trustees of Phillips Acad. v. King, 12 Mass. 547, 575; 1816, Rex v. Bishop of Worcester, 4 M. & S. 415; 1819, Trustees of Dartmouth College v. Woodward, 4 Wheat. 518, on 668, 674, *supra*, p. 708, on 729, 742; 1827, Fuller v. Plainfield Academy, 6 Conn. 532, 544; 1828, Amherst Academy v. Cows, 6 Pick. (23 Mass.) 427, 17 Am. Dec. 387; 1828, Appeal of Murdock, 7 Pick. (24 Mass.) 303; 1831, Murdock v. Phillips Academy, 12 Pick. (Mass.) 244; 1833, Allen v. McKean, 1 Sum. 276, Fed. Cas. 229; 1838, Regents of Univ. of Md. v. Williams, 9 G. & J. (Md.) 401, 31 Am. Dec. 72; 1841, Chambers v. Baptist Ed. Soc., 1 B. Mon. (Ky.) 213, 219; 1848, Nelson v. Cushing, 2 Cush. (56 Mass.) 519; 1863, Thompson v. Univ. of London, 33 L. J. Ch. 625; 1869, State v. Georgia Med. Col., 38 Ga. 608, *supra*, p. 136; 1869, State v. Adams, 44 Mo. 570; 1875, *In re Taylor Orphan Asylum*, 36 Wis. 534; 1877, Juvenile Guardian Soc. v. Roosevelt, 7 Daly (N. Y.) 188; 1878, United States v. Union Pac. R. Co., 98 U. S. 569; 1881, American Printing House v. Trustees, 104 U. S. 711; 1894, Trustees v. Hunn, 7 Tex. Civ. App. 249.

**Sec. 429. 2. Public visitor or officer.**

See *Eagle Insurance Co. v. Ohio*, 153 U. S. 446, *infra*, p. 1363; *Smyth v. Ames*, 169 U. S. 466, *infra*, p. 1352.

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ARTICLE III. CONTROL BY LEGISLATIVE ACTION.

**Sec. 430. 1. Ordinary.****(1) Eminent domain proceedings.**

See *Proprietors of Piscataqua Bridge v. New Hampshire Bridge*, 7 N. H. 35, *supra*, p. 309.

**Sec. 430a. Same.**


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THE WEST RIVER BRIDGE COMPANY v. DIX ET. AL.<sup>1</sup>

1848. IN THE SUPREME COURT OF THE UNITED STATES. 47 U. S.  
(6 How.) Rep. 507-550.

[Error from supreme court of Vermont. In 1795 the bridge company was incorporated for 100 years with the exclusive privilege of erecting a bridge at a certain place over West river, and taking tolls for the same; the bridge was duly constructed. In 1839, the legislature of Vermont provided by general law for the taking "of any real estate, easement, or franchise of any turnpike or other corporation" when the public good should require, upon making compensation. Under these statutes the public authorities laid out a public highway passing over this bridge, and took the proper steps to appropriate it to the public use. The bridge company presented a bill to enjoin these proceedings; this bill, upon demurrer, was dismissed, and error prosecuted in the supreme court, which affirmed the decision below.]

MR. JUSTICE DANIEL. \* \* \* In considering the question propounded in these causes, there can be no doubt, nor has it been doubted in argument, on either side of this controversy, that the charter of incorporation granted to the plaintiffs in 1793, with the rights and privileges it declared or implied, formed a contract between the plaintiffs and the state of Vermont, which the latter, under the inhibition in the tenth section of the first article of the constitution, could have no power to impair. Yet this proposition, though taken as a postulate on both sides, determines nothing as to the real merits of these causes. True, it furnishes a guide to our inquiries, yet leaves those inquiries still open, in their widest extent, as to the real position of the parties with reference to the state legislation or to the constitu-

<sup>1</sup> Statement abridged. Part of opinion of Justice Daniel, all of concurring opinions of McLean and Woodbury, JJ., and arguments omitted.

tion. Following the guide thus furnished us, we will proceed to ascertain that position. No state, it is declared, shall pass a law impairing the obligation of contracts; yet, with this concession constantly yielded, it can not be justly disputed that in every political sovereign community there inheres necessarily the right and the duty of guarding its own existence, and of protecting and promoting the interests and welfare of the community at large. This power and this duty are to be exerted not only in the highest acts of sovereignty, and in the external relations of governments; they reach and comprehend likewise the interior polity and relations of social life, which should be regulated with reference to the advantage of the whole society. This power, denominated the *eminent domain* of the state, is, as its name imports, paramount to all private rights vested under the government, and these last are, by necessary implication, held in subordination to this power, and must yield in every instance to its proper exercise.

The constitution of the United States, although adopted by the sovereign states of this union, and proclaimed in its own language to be the supreme law for their government, can, by no rational interpretation, be brought to conflict with this attribute in the states; there is no express delegation of it by the constitution, and it would imply an incredible fatuity in the states to ascribe to them the intention to relinquish the power of self-government and self-preservation. A correct view of this matter must demonstrate, moreover, that the right of eminent domain in government in nowise interferes with the inviolability of contracts; that the most sanctimonious regard for the one is perfectly consistent with the possession and exercise of the other.

Under every established government the tenure of property is derived mediately or immediately from the sovereign power of the political body, organized in such mode or exerted in such way as the community or state may have thought proper to ordain. It can rest on no other foundation, can have no other guarantee. It is owing to these characteristics only, in the original nature of tenure, that appeals can be made to the laws either for the protection or assertion of the rights of property. Upon any other hypothesis the law of property would be simply the law of force. Now it is undeniable that the investment of property in the citizen by the government, whether made for a pecuniary consideration or founded on conditions of civil or political duty, is a contract between the state, or the government acting as its agent, and the grantee, and both the parties thereto are bound in good faith to fulfill it. But into all contracts, whether made between states and individuals or between individuals only, there enter conditions which arise not out of the literal terms of the contract itself; they are superinduced by the pre-existing and higher authority of the laws of nature, of nations, or of the community to which the parties belong; they are always presumed, and must be presumed, to be known and recognized by all, are binding upon all, and need never, therefore, be carried into express stipulation, for this could add



nothing to their force. Every contract is made in subordination to them, and must yield to their control, as conditions inherent and paramount, wherever a necessity for their execution shall occur. Such a condition is the right of eminent domain. This right does not operate to impair the contract effected by it, but recognizes its obligation in the fullest extent, claiming only the fulfillment of an essential and inseparable condition. Thus, in claiming the resumption or qualification of an investiture, it insists merely on the true nature and character of the right invested.

The impairing of contracts inhibited by the constitution can scarcely, by the greatest violence of construction, be made applicable to the enforcing of the terms or necessary import of a contract; the language and meaning of the inhibition were designed to embrace proceedings attempting the interpolation of some new term or condition foreign to the original agreement, and, therefore, inconsistent with and violative thereof. It, then, being clear that the power in question not being within the purview of the restriction imposed by the tenth section of the first article of the constitution, it remains with the states to the full extent in which it inheres in every sovereign government, to be exercised by them in that degree that shall by them be deemed commensurate with public necessity. So long as they shall steer clear of the single predicament denounced by the constitution, shall avoid interference with the obligation of contracts, the wisdom, the modes, the policy, the hardship of any exertion of this power are subjects not within the proper cognizance of this court. This is, in truth, purely a question of power; and, conceding the power to reside in the state government, this concession would seem to close the door upon all further controversy in connection with it. The instances of the exertion of this power, in some mode or other, from the very foundation of civil government, have been so numerous and familiar that it seems somewhat strange, at this day, to raise a doubt or question concerning it. In fact, the whole policy of the country, relative to roads, mills, bridges and canals, rests upon this single power, under which lands have been always condemned, and without the exertion of this power, not one of the improvements just mentioned could be constructed. In our country it is believed that the power was never, or, at any rate, rarely questioned, until the opinion seems to have obtained that the right of property in a chartered corporation was more sacred and intangible than the same right could possibly be in the person of the citizen, an opinion which must be without any grounds to rest upon, until it can be demonstrated either that the ideal creature is more than a person, or the corporeal being is less. For, as a question of the power to appropriate to public uses the property of private persons, resting upon the ordinary foundations of private right, there would seem to be room neither for doubt nor difficulty. A distinction has been attempted, in argument, between the power of a government to appropriate for public uses property which is corporeal, or may be said to be in being, and the like power in the government to resume or extinguish a franchise. The distinction thus attempted we



regard as a refinement which has no foundation in reason, and one that, in truth, avoids the true legal or constitutional question in these causes, namely, that of the right in private persons, in the use or enjoyment of their private property, to control and actually to prohibit the power and duty of the government to advance and protect the general good. We are aware of nothing peculiar to a franchise which can class it higher, or render it more sacred, than other property.

A franchise is property, and nothing more; it is incorporeal property, and is so defined by Justice Blackstone, when treating, in his second volume, ch. 3, page 20, of the Rights of Things. It is its character of property only which imparts to it value, and alone authorizes in individuals a right of action for invasions or disturbances of its enjoyment. *Vide* Bl. Com., Vol. III, ch. 16, p. 236, as to injuries to this description of private property, and the remedies given for redressing them. A franchise, therefore, to erect a bridge, to construct a road, to keep a ferry and to collect tolls upon them, granted by the authority of the state, we regard as occupying the same position, with respect to the paramount power and duty of the state to promote and protect the public good, as does the right of the citizen to the possession and enjoyment of his land under his patent or contract with the state, and it can no more interpose any obstruction in the way of their just exertion. Such exertion we hold to be not within the inhibition of the constitution, and no violation of a contract. The power of a state in the exercise of eminent domain, to extinguish immediately a franchise it had granted, appears never to have been directly brought here for adjudication, and consequently has not been heretofore formally propounded from this court; but in England this power, to the fullest extent, was recognized in the case of the Governor and Company of the Cast Plate Manufacturers v. Meredith, 4 T. R. 794, and Lord Kenyon, especially in that case, founded solely upon this power the entire policy and authority of all the road and canal laws of the kingdom.

The several state decisions cited in the argument, from 3 Paige (N. Y.) 45, from 23 Pick. (Mass.) 361, from 17 Conn. 454, from 8 N. H. 398, from 10 N. H. 371 and from 11 N. H. 20, are accordant with the decision above mentioned, from 4 T. R., and entirely supported by it. \* \* \*

Decision of supreme court of Vermont affirmed. Justice Wayne dissented.

See note, *infra*, p. 1343.

Sec. 431. Same.

CLOPTON, J., IN MOBILE & GIRARD RAILROAD CO. v. ALABAMA MIDLAND RAILWAY CO.

1888. IN THE SUPREME COURT OF ALABAMA. 87 Ala. 501, on 506, 507, 508, 509.

The power of the general assembly to take the property and franchises of incorporated companies, and to apply them to another pub-

lic use deemed more important, upon just compensation being first made, is conceded. \* \* \*

The settled rule is, that the legislative intent to grant authority to one railroad to take and condemn a franchise of another must appear in express terms, or must arise from necessary implication, founded on an existing and particular need. No room for doubt or uncertainty must be left. Should the general assembly empower a company to construct a railroad between designated and fixed terminal points, and, to accomplish this object, it becomes necessary to take the franchises, or any part, of another corporation, power to do so arises from necessary implication, the presumption being that the legislature deemed the later use the more important and of greater public benefit. The implication rests on the general rule that the grant of power to do a particular thing of a public nature carries with it implied authority to do all that is necessary to accomplish the principal and general purpose. \* \* \*

A franchise to acquire, hold and use land for a right of way, is in its very nature exclusive, that the privileges and powers granted in respect to its use may be fully exercised. Dispossession of property, subject to the use of a franchise and in actual use, is, to all intents, deprivation of the right to exercise the franchise as to such property—tantamount, in its legal effect, to the taking of the franchise *pro tanto*. We adopt the rule as stated, 1 Wood's Railway Law, § 229: "One public corporation can not take the lands or franchises of another public corporation *in actual use by it*, unless expressly authorized to do so by the legislature; but the lands of such a corporation not in actual use may be taken by another corporation authorized to take lands for its use *in invitum*, whenever the lands of an individual may be taken, subject to the qualification that there is a necessity therefor;" with the modification, in order to avoid misunderstanding, that the authority may be implied in a proper case, and the use must be reasonably requisite to the free exercise of the franchise—not for the mere purpose to prevent the exercise of the right of eminent domain. This rule furnishes the boundary of the delegated authority to take, which is *actual* use of the property by the adversary corporation, and the reasonable necessity of its use to the safe, proper and convenient management of the corporate business, and the accomplishment of the purposes of its creation. Taking the property must not materially diminish or impair the usefulness of a franchise in exercise. \* \* \*

It would be difficult to lay down any specific rule as to the measure of the necessity of sufficient scope to include all cases. It may be observed generally that *necessary*, in this connection, does not mean an absolute or indispensable necessity, but reasonably requisite and proper for the accomplishment of the end in view under the particular circumstances of the case. \* \* \*

See note, *infra*, p. 1343. Compare 1901, Edison Elec. L., etc., Co. v. Merchants' & Mfrs., etc., Co., 200 Pa. St. 209, 86 Am. St. R. 712, 49 Atl. 952; 1901, Postal Tel., etc., Co. v. Oregon, etc., Ry. Co., 23 Utah 474, 90 Am. St. R. 705, 65 Pac. 735.

**Sec. 432. Same.**

PAXSON, J., IN SHARON RAILWAY COMPANY'S APPEAL.

1888. IN SUPREME COURT OF PENNSYLVANIA. 122 Pa. St. 533,  
on 544, 9 Am. St. Rep. 133, on 135.

We have then the finding of the master, based upon ample testimony, that the land in question was acquired by the appellant company for the uses of its road, and that the same is necessary therefor. Can it now be taken by another corporation for the same or a similar use? It certainly can not be done for the mere convenience or profit of the latter. To justify such taking there must be a necessity, "a necessity so absolute that without it the grant itself will be defeated. It must also be a necessity that arises from the very nature of things over which the corporation has no control; it must not be created by the company itself for its own convenience or for the sake of economy." Pennsylvania Railroad Co.'s Appeal, 93 Pa. 150. To the same effect is Pittsburgh Junction Railroad Co.'s Appeal, 122 Pa. St. 511. I will not stop to discuss or vindicate this rule. It is settled law, and rests upon sound principles.

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**Sec. 433. Same.**

MR. CHIEF JUSTICE DICKEY IN LAKE SHORE AND MICHIGAN  
SOUTHERN RAILWAY CO. v. CHICAGO AND WESTERN IN-  
DIANA RAILROAD CO.

1881. IN THE SUPREME COURT OF ILLINOIS. 97 Ill. Rep. 506, on  
512-513.

Counsel for plaintiffs in error, after stating the proposition, that the general assembly of this state has no power, under our constitution, to take, or to authorize the taking, of private property from one owner for the mere purpose of giving it to another, and that it is only where such taking is "for public use" that the power of eminent domain can rightfully be exercised, insist that where property has already been appropriated to public use, and is, in fact, in such use in the hands of one corporation, it can not be rightfully taken (even by the authority of the statute to that effect) away from such corporation, for the purpose of subjecting it to the same public use in the hands of another corporation. This position we do not question. Where the public use in question is *the same*, such taking would undoubtedly degenerate into a taking from one for the mere purpose of giving to another, which we hold (under our institutions) is not within the domain of legislative power.

To warrant the taking of property of one party, already appropriated to a public use, and placing it wholly or in part in the hands of another party for a public use, it is essential that the new use be a

different use, and also that the change from the present use to the new use shall be for the benefit of the public. Whether the new use be different from the present use, is a judicial question which courts may decide. But where the new use, in its nature, *may* be a public benefit, whether the change *will be* for the benefit of the public is a political question, to be determined by a political department of the government, and generally, if not always, by the law-making power.

The new use in the case at bar, in its nature, *may be* a public benefit, and clearly it is not the same use. By the present use the public has the benefit of an easement upon these premises for the passage of freight and passengers along the lines already constructed, leading to and from certain points and regions of country.

By the new use—the use sought by the condemnation proceedings in question—the public will have the benefit of an easement upon these premises for the passage of freight and passengers along another and an additional line leading to and from certain other and different points and regions. Heretofore these premises have been subjected to the exclusive use of complainants in the movement of their trains. The new use to which it is proposed to subject these premises is a joint use, or rather, a co-operative use, to be exercised and enjoyed by both complainants and defendants, so as to furnish to the public an additional line of travel and transportation.

*Note. Eminent domain*—taking property already devoted to a public use. Property already devoted to a public use may, by express statutory authority, be taken for another public use under eminent domain proceedings, and by the weight of authority it may be taken for a similar or the same public use. But such a right will not be implied, unless the necessity is so great as that the subsequent grant would be ineffective, or unless the interference is so slight or so usual as to be fairly contemplated by the grant made: 1834, *Piscataqua B. Co. v. N. H. Bridge Co.*, 7 N. H. 67, *supra*, p. 309; 1837, *Charles River Bridge Co. v. Warren Bridge Co.*, 11 Pet. (U. S.) 420; 1840, *Tuckahoe Canal Co. v. Tuckahoe R. Co.*, 11 Leigh (Va.) 42, 36 Am. Dec. 374; 1840, *Backus v. Lebanon*, 11 N. H. 19, 35 Am. Dec. 466 (a toll road may be taken and converted into a free road); 1843, *Armington v. Barnet*, 15 Vt. 745, 40 Am. Dec. 705 (same); 1848, *West River Bridge Co. v. Dix*, 6 How. (47 U. S.) 507, *supra*, p. 1337 (a toll bridge may be made free); 1853, *Northern R. Co. v. Concord*, etc., R., 27 N. H. 194 (one railroad can take half a mile of the right of way of another); 1859, *Boston & Lowell R. Co. v. Salem & L. R. Co.*, 2 Gray 1 (an exclusive grant can be taken under power of eminent domain); 1859, *Lafayette Plank Road v. New Albany*, etc., R. Co., 13 Ind. 90, 74 Am. Dec. 246 (railroad parallel to a turnpike); 1859, *State v. S. P. R. Co.*, 24 Texas 80, on 127; 1862, *In re* *Petition of Clev. & P. R.*, 2 Pitts. Rep. 348, 10 Pitts. Rep. 74; 1864, *In matter of Kerr*, 42 Barb. (N. Y.) 119 (a street car company may be authorized to use the tracks of another street car company); 1869, *New York*, etc., R. Co. v. *Boston*, etc., R. Co., 36 Conn. 196; 1869, *City of Bridgeport v. N. Y.*, etc., R. Co., 36 Conn. 255, 4 Am. Rep. 63; 1871, *Balt. & H. G. T. Co. v. Union R.*, etc., 35 Md. 224, 231 (railroad can be authorized to cross a turnpike); 1872, *Eastern R. Co. v. Boston & M. R.*, 111 Mass. 125, 15 Am. Rep. 13 (one railroad company may take the property of another for a passenger station); 1872, *Peoria P. & J. R. Co. v. Peoria & S. R. Co.*, 66 Ill. 174 (railroad lands not actually in use may be appropriated by another railroad company); 1874, *Chicago*, etc., R. Co. v. *Town of Lake*, 71 Ill. 333; 1874, *Cincinnati L. F.*, etc., R. Co. v. *Danville*, etc., R. Co., 75 Ill. 113, *supra*, p. 664, (fraudulent appropriation); 1875, *In re* *N. Y.*

C. & H. R. Co. v. M. G. L. Co., 63 N. Y. 326, 334 (lands of a gas company can be appropriated by a railroad company); 1875, Metropolitan R. Co. v. Highland St. R. Co., 118 Mass. 290 (a street railway company may be authorized to take the tracks of another, or appropriate the right to use them); 1875, Evergreen Cemetery Assn. v. New Haven, 43 Conn. 234, 21 Am. Rep. 643 (taking land of a cemetery for a road); 1876, The Central City Horse R. Co. v. The Ft. C. H. R. Co. 81 Ill. 523 (a new railroad company can condemn the property of an old); 1877, Metropolitan City R. Co. v. Chicago, etc., R. Co., 87 Ill. 317 (one street car company can condemn the right of another company not to have cars run on a particular street); 1877, Grand Rapids, etc., R. Co. v. G. R. & I. R., 35 Mich. 265, 24 Am. Rep. 545 (railroad crossing another); 1878, Boston & M. R. Co. v. Lowell & I. R. Co., 124 Mass. 368 (a longitudinal taking requires an express grant); 1880, St. Louis, Jacksonville, etc., R. Co. v. Springfield, etc., R. Co., 96 Ill. 274 (railroad crossing another); 1880, Citizens' Coach Co. v. Camden H. R., 33 N. J. Eq. 267 (use of a street upon which is a railway by other parties); 1881, A., T. & S. F. R. Co. v. A. & W. R. Co., 75 Va. 780 (property of one company may be taken for the same use by another company, if expressly authorized); 1881, Baltimore & Ohio R. Co. v. P., W. & Ky. R., 17 W. Va. 812 (same); 1883, Pennsylvania R. Co. v. B. & O. R. Co., 60 Md. 263 (taking of five miles of railroad for use of another railroad company); 1884, East St. Louis C. R. Co. v. E. St. L. U. R. Co., 108 Ill. 265 (parallel lines); 1884, C. & N. W. R. Co. v. C. & E. R. Co., 112 Ill. 589 (where there is a change of use the question is one of legislative intent); 1887, Illinois Central R. v. Chicago, B. & N. R. Co., 122 Ill. 473 (taking of eleven miles of railroad by another railroad company—legislature can authorize); 1888, Appeal of Pittsburgh Junction R., 122 Pa. St. 511, 9 Am. St. Rep. 128 (special authority required); 1888, Appeal of Sharon R., 122 Pa. St. 533, 9 Am. St. Rep. 133, note 137, *supra*, p. 1342; 1888, Philadelphia, N., etc., R. Co. Appeal, 120 Pa. St. 90 (a turnpike may be converted into a free road); 1888, Mobile & G. R. Co. v. Alabama, etc., 87 Ala. 591, *supra*, p. 1340; 1890, Colorado E. Ry. Co. v. Union Pac. R. Co., 41 Fed. Rep. 293 (property of one railroad company not already in use may be taken by another); 1895, Butte A. & P. R. Co. v. Montana U. R. Co., 16 Mont. 504 (in case of necessity one railroad company may take part of the right of way of another).

A stricter rule than the one stated above is maintained by the following cases: 1832, Chesapeake and Ohio Canal Co. v. B. & O. R., 4 Gill & J. (Md.) 1; 1881, L. S. & M. S. R. v. C. W. & I. R. Co., 97 Ill. 506, *supra*, p. 1342; 1888, Mobile & G. R. Co. v. Alabama, etc., Co., 87 Ala. 501, *supra*, p. 1340.

#### Sec. 434. (2) Police control.<sup>1</sup>

##### (a) In general.

#### THORPE v. THE RUTLAND AND BURLINGTON RAILROAD COMPANY.<sup>2</sup>

1855. IN THE SUPREME COURT OF VERMONT. 27 Vt. Rep. 140-156, 62 Am. Dec. 625.

[Action on the case to recover damages for sheep killed by the defendants' locomotives, upon their track, where the sheep had escaped because no cattle-guard had been constructed as required by the law of 1849, enacted after the grant of the charter which contained no such

<sup>1</sup> As to control of national government over state corporations, see, *infra*, §§ 499-505.

<sup>2</sup> Much of opinion omitted; only the line of argument given.

provision, and no provision for repealing or amending the charter. Decision below for plaintiff.]

REDFIELD, CH. J. I. The present case involves the question of the right of the legislature to require existing railways to respond in damages for all cattle killed or injured by their trains until they erect suitable cattle-guards at farm-crossings. No question could be made where such a requisition was contained in the charter of the corporation, or in the general laws of the state at the date of the charter. But where neither is the case, it is claimed that it is incompetent for the legislature to impose such an obligation by statute, subsequent to the date of the charter.

It has never been questioned, so far as I know, that the American legislatures have the same unlimited power in regard to legislation which resides in the British parliament, except where they are restrained by written constitutions. That must be conceded, I think, to be a fundamental principle in the political organizations of the American states. We can not well comprehend how, upon principle, it should be otherwise. The people must, of course, possess all legislative power originally. They have committed this in the most general and unlimited manner to the several state legislatures, saving only such restrictions as are imposed by the constitution of the United States, or of the particular state in question. I am not aware that the constitution of this state contains any restriction upon the legislature in regard to corporations, unless it be that where "any person's property is taken for the use of the public, the owner ought to receive an equivalent in money," or that there is any such restriction in the United States constitution, except that prohibiting the states from "passing any law impairing the obligation of contracts."

It is a conceded point, upon all hands, that the parliament of Great Britain is competent to make any law binding upon corporations, however much it may increase their burdens or restrict their powers, whether general or organic, even to the repeal of their charters.

This extent of power is recognized in the case of *Dartmouth College v. Woodward*, 4 Wheaton 518, and the leading authorities are there referred to. Any requisite amount of authority, giving this unlimited power over corporations to the British parliament, may readily be found. And if, as we have shown, the several state legislatures have the same extent of legislative power, with the limitations named, the inviolability of these artificial bodies rests upon the same basis in the American states with that of natural persons, and there are, no doubt, many of the rights, powers and functions of natural persons which do not come within legislative control. Such, for instance, as are purely and exclusively of private concern, and in which the body politic, as such, have no special interest.

II. It being assumed, then, that the legislature may control the action, prescribe the functions and duties of corporations, and impose restraints upon them to the same extent as upon natural persons, that is, in all matters coming within the general range of legislative au-



thority, subject to the limitation of not impairing the obligation of contracts, provided the essential franchise is not taken without compensation, it becomes of primary importance to determine the extent to which the charter of a corporation may fairly be regarded as a contract within the meaning of the United States constitution. \* \* \*

Chief Justice Marshall, in *Dartmouth College v. Woodward*, 4 Wheaton 518, says: "A corporation is an artificial being—the mere creature of the law—it possesses only those properties which the charter of its creation confers upon it, either expressly or as incidental to its very existence." The decision throughout treats this as the fundamental idea, the pivot upon which the case turns. The charter of a corporation is thus regarded as a contract, inasmuch as it is an implied undertaking on the part of the state, that the corporation, as such, and for the purposes therein named or implied, shall enjoy the powers and franchises by its charter conferred. And any statute essentially modifying these corporate franchises is there regarded as a violation of the charter. But when we come to inquire what is meant by the franchise of a corporation, the principal difficulty arises. Certain things, it is agreed, are essential to the beneficial existence and successful operation of a corporation, such as individuality and perpetuity, when the grant is unlimited; the power to sue and to be sued, to have a common seal and to contract; and in the case of a railroad, to have a common stock to construct and maintain its road, and to operate the same for the common benefit of the corporators. Certain other things, as incident to the beneficial use of these franchises, are necessarily implied. But there is a wide field of debatable ground outside of all these. It is conceded that the powers expressly, or by necessary implication, conferred by the charter, and which are essential to the successful operation of the corporations, are inviolable. \* \* \*

"The great object of an incorporation is to bestow the character and properties of individuality on a collected and changing body of men. Any privileges which may exempt it from the burdens common to individuals do not flow necessarily from the charter, *but must be expressed in it, or they do not exist.*"

This is sufficiently explicit, and upon examination will be found, I think, to have placed the matter upon its true basis. In reason, it would seem that no fault could be found with the rule here laid down by the great expounder of American constitutional law. As to the general liability to legislative control, it places natural persons and corporations precisely upon the same ground. And it is the true ground, and the only one upon which equal rights and just liabilities and duties can be fairly based. \* \* \*

We think the power of the legislature to control existing railways in this respect, may be found in the general control over the police of the country, which resides in the law-making power in all free states, and which is, by the fifth article of the bill of rights of this state, expressly declared to reside perpetually and inalienably in the legislature, which is, perhaps, no more than the enunciation of a general principle applicable to all free states, and which can not, therefore,

be violated so as to deprive the legislature of the power, even by express grant to any mere public or private corporation. And when the regulation of the police of a city or town, by general ordinances, is given to such towns and cities, and the regulation of their own internal police is given to railroads to be carried into effect by their by-laws and other regulations, it is, of course, always in all such cases, subject to the superior control of the legislature. That is a responsibility which legislatures can not divest themselves of, if they would.

This police power of the state extends to the protection of the lives, limbs, health, comfort and quiet of all persons, and the protection of all property within the state. According to the maxim, *Sic utere tuo ut alienum non laedas*, which, being of universal application, it must, of course, be within the range of legislative action to define the mode and manner in which every one may so use his own as not to injure others. So far as railroads are concerned, this police power, which resides primarily and ultimately in the legislature, is twofold:

1. The police of the roads, which, in the absence of legislative control, the corporations themselves exercise over their operatives, and to some extent over all who do business with them, or come upon their grounds, through their general statutes, and by their officers. We apprehend there can be no manner of doubt that the legislature may, if they deem the public good requires it, of which they are to judge, and in all doubtful cases their judgment is final, require the several railroads in the state to establish and maintain the same kind of police which is now observed upon some of the more important roads in the country for their own security, or even such a police as is found upon the English railways, and those upon the continent of Europe. \* \* \*

2. There is also the general police power of the state, by which persons and property are subjected to all kinds of restraints and burdens, in order to secure the general comfort, health, and prosperity of the state, of the perfect right, in the legislature to do which no question ever was, or, upon acknowledged general principles, ever can be made, so far as natural persons are concerned. And it is certainly calculated to excite surprise and alarm, that the right to do the same in regard to railways should be made a serious question. This objection is made generally upon two grounds: 1. That it subjects corporations to virtual destruction by the legislature; and 2. That it is an attempt to control the obligation of one person to another, in matters of merely private concern.

All the cases agree that the indispensable franchises of a corporation can not be destroyed or essentially modified. This is the very point upon which the leading case of *Dartmouth College v. Woodward* was decided, and which every well-considered case in this country maintains. But when it is attempted upon this basis to deny the power of regulating the internal police of the railroads, and their mode of transacting their general business, so far as it tends unreasonably to infringe the rights or interests of others, it is putting the whole subject of railway control quite above the legislation of the country. \* \* \*

I do not now perceive any just ground to question the right of the

legislature to make railways liable for all cattle killed by their trains. It might be unjust or unreasonable, but none the less competent. *Girtman v. Central Railroad*, 1 *Kelly* (Georgia) 173, is sometimes quoted as having held a different doctrine, but no such point is to be found in the case. The British parliament for centuries, and most of the American legislatures, have made the protection of the lives of domestic animals the subject of penal enactment. It would be wonderful if they could not do the same as to railways, or if they could not punish the killing, by requiring them to compensate the owner, or, as in the present case, to do it until they used certain precautions in running their trains, to wit: Maintained cattle-guards at roads and farm-crossings. \* \* \*

Judgment affirmed. Bennet, J., dissenting.

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Sec. 435. Same.

STONE V. MISSISSIPPI.

1879. IN THE SUPREME COURT OF THE UNITED STATES. 101 U. S. 814-821.

WAITE, C. J. It is now too late to contend that any contract which a state actually enters into when granting a charter to a private corporation, is not within the protection of the clause in the constitution of the United States that prohibits states from passing laws impairing the obligation of contracts. Article 1, section 10. The doctrines of the *Trustees of Dartmouth College v. Woodward*, 4 *Wheat.* 518, announced by this court more than sixty years ago, have become so imbedded in the jurisprudence of the United States as to make them, to all intents and purposes, a part of the constitution itself. In this connection, however, it is to be kept in mind that it is not the charter which is protected, but only any contract the charter may contain. If there is no contract, there is nothing in the grant on which the constitution can act. Consequently, the first inquiry in this class of cases always is, whether a contract has, in fact, been entered into, and if so, what its obligations are.

In the present case the question is, whether the state of Mississippi, in its sovereign capacity, did, by the charter now under consideration, bind itself irrevocably by a contract to permit "The Mississippi Agricultural, Educational and Manufacturing Aid Society," for twenty-five years, "to receive subscriptions, and sell and dispose of certificates of subscriptions which shall entitle the holders thereof to" "any lands, books, paintings, antiques, scientific instruments or apparatus, or any other property or thing that may be ornamental, valuable or useful," "awarded to them" "by the casting of lots, or by lot, chance or otherwise." There can be no dispute but that, under this form of words, the legislature of the state chartered a lottery company, having all the powers incident to such a corporation, for twenty-five years, and that,

in consideration thereof, the company paid into the state treasury \$5,000 for the use of a university, and agreed to pay, and until the commencement of this suit did pay, an annual tax of \$1,000 and "one-half of one per cent. on the amount of receipts derived from the sale of certificates or tickets." If the legislature that granted this charter had the power to bind the people of the state and all succeeding legislatures to allow the corporation to continue its corporate business during the whole term of its authorized existence, there is no doubt about the sufficiency of the language employed to effect that object, although there was an evident purpose to conceal the vice of the transaction by the phrases that were used. Whether the alleged contract exists, therefore, or not, depends upon the authority of the legislature to bind the state and the people of the state in that way.

All agree that the legislature can not bargain away the police power of a state. "Irrevocable grants of property and franchises may be made if they do not impair the supreme authority to make laws for the right government of the state; but no legislature can curtail the power of its successors to make such laws as they may deem proper in matters of police." *Metropolitan Board of Excise v. Barrie*, 34 N. Y. 657; *Boyd v. Alabama*, 94 U. S. 645. Many attempts have been made in this court and elsewhere to define the police power, but never with entire success. It is always easier to determine whether a particular case comes within the general scope of the power than to give an abstract definition of the power itself which will be in all respects accurate. No one denies, however, that it extends to all matters affecting the public health or the public morals. *Beer Company v. Massachusetts*, 97 U. S. 25; *Patterson v. Kentucky*, 97 U. S. 501. Neither can it be denied that lotteries are proper subjects for the exercise of this power. We are aware that formerly, when the sources of public revenue were fewer than now, they were used in some or all of the states, and even in the District of Columbia, to raise money for the erection of public buildings, making public improvements, and not unfrequently for educational and religious purposes; but this court said, more than thirty years ago, speaking through Mr. Justice Grier, in *Phalen v. Virginia*, 8 How. 163, 168, that "experience has shown that the common forms of gambling are comparatively innocuous when placed in contrast with the widespread pestilence of lotteries. The former are confined to a few persons and places, but the latter infests the whole community; it enters every dwelling; it reaches every class; it preys upon the hard earnings of the poor, and it plunders the ignorant and simple." Happily, under the influence of restrictive legislation, the evils are not so apparent now; but we very much fear that, with the same opportunities of indulgence, the same results would be manifested.

If lotteries are to be tolerated at all, it is, no doubt, better that they should be regulated by law, so that the people may be protected as far as possible against the inherent vices of the system; but that they are demoralizing in their effects, no matter how carefully regulated, can not admit of a doubt. When the government is untrammelled by

any claim of vested rights or chartered privileges, no one has ever supposed that lotteries could not lawfully be suppressed, and those who manage them punished severely as violators of the rules of social morality. From 1822 to 1867, without any constitutional requirement, they were prohibited by law in Mississippi, and those who conducted them punished as a kind of gamblers. During the provisional government of that state, in 1867, at the close of the late civil war, the present act of incorporation, with more of like character, was passed. The next year, 1868, the people, in adopting a new constitution with a view to the resumption of their political rights as one of the United States, provided that "the legislature shall never authorize any lottery, nor shall the sale of lottery tickets be allowed, nor shall any lottery heretofore authorized be permitted to be drawn, or tickets therein to be sold." Art. 12, § 15. There is now scarcely a state in the union where lotteries are tolerated, and congress has enacted a special statute, the object of which is to close the mails against them. Rev. St., § 3894; 19 Stat. at L., 90, § 2

The question is, therefore, directly presented, whether, in view of these facts, the legislature of a state can, by the charter of a lottery company, defeat the will of the people, authoritatively expressed, in relation to the further continuance of such business in their midst. We think it can not. No legislature can bargain away the public health or the public morals. The people themselves can not do it, much less their servants. The supervision of both these subjects of governmental power is continuing in its nature, and they are to be dealt with as the special exigencies of the moment may require. Government is organized with a view to their preservation, and can not divest itself of the power to provide for them. For this purpose, the largest legislative discretion is allowed, and the discretion can not be parted with any more than the power itself. *Beer Co. v. Massachusetts, supra.*

In *Trustees of Dartmouth College v. Woodward*, 4 Wheat. 518, it was argued that the contract clause of the constitution, if given the effect contended for in respect to corporate franchises, "would be an unprofitable and vexatious interference with the internal concerns of a state, would, unnecessarily and unwisely, embarrass its legislation, and render immutable those civil institutions which are established for the purpose of internal government, and which, to subserve those purposes, ought to vary with varying circumstances" (p. 628); but Mr. Chief Justice Marshall, when he announced the opinion of the court, was careful to say (p. 629), "that the framers of the constitution did not intend to restrain states in the regulation of their civil institutions, adopted for internal government, and that the instrument they have given us is not to be so construed." The present case, we think, comes within this limitation. We have held, not, however, without strong opposition at times, that this clause protected a corporation in its charter exemptions from taxation. While taxation is, in general, necessary for the support of government, it is not part of the government itself. Government was not organized for the purposes of tax-



ation, but taxation may be necessary for the purposes of government. As such, taxation becomes an incident to the exercise of the legitimate functions of government, but nothing more. No government, dependent on taxation for support, can bargain away its whole power of taxation, for that would be substantially abdication. All that has been determined thus far is, that for a consideration it may, in the exercise of a reasonable discretion, and for the public good, surrender a part of its powers in this particular. \* \* \*

But the power of governing is a trust committed by the people to the government, no part of which can be granted away. The people, in their sovereign capacity, have established their agencies for the preservation of the public health and the public morals, and the protection of public and private rights. These several agencies can govern according to their discretion, if within the scope of their general authority, while in power; but they can not give away nor sell the discretion of those that are to come after them, in respect to matters the government of which, from the very nature of things, must "vary with varying circumstances." They may create corporations, and give them, so to speak, a limited citizenship; but as citizens, limited in their privileges, or otherwise, these creatures of the government creation are subject to such rules and regulations as may from time to time be ordained and established for the preservation of health and morality.

The contracts which the constitution protects are those that relate to property rights, not governmental. It is not always easy to tell on which side of the line which separates governmental from property rights a particular case is to be put; but in respect to lotteries there can be no difficulty. They are not, in the legal acceptance of the term, *mala in se*, but as we have just seen, may properly be made *mala prohibita*. They are a species of gambling, and wrong in their influences. They disturb the checks and balances of a well-ordered community. Society built on such a foundation would almost of necessity bring forth a population of speculators and gamblers, living on the expectation of what, "by the casting of lots, or by lot, chance or otherwise," might be "awarded" to them from the accumulations of others. Certainly the right to suppress them is governmental, to be exercised at all times by those in power, at their discretion. Anyone, therefore, who accepts a lottery charter, does so with the implied understanding that the people, in their sovereign capacity and through their properly constituted agencies, may resume it at any time when the public good shall require, whether it be paid for or not. All that one can get by such a charter is a suspension of certain governmental rights in his favor, subject to withdrawal at will. He has, in legal effect, nothing more than a license to enjoy the privilege on the terms named for the specified time, unless it be sooner abrogated by the sovereign power of the state. It is a permit, good as against existing laws, but subject to future legislative and constitutional control or withdrawal.



On the whole, we find no error in the record, and the judgment is affirmed.

See note, *infra*, p. 1366.

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**Sec. 436. Same.**

**(b) Regulation of rates.**

**SMYTH v. AMES.<sup>1</sup>**

**1898. IN THE SUPREME COURT OF THE UNITED STATES. 169 U. S. Rep. 466-550.**

[Suit by the stockholders of various railroad companies, on behalf of themselves and others similarly situated, against their respective companies, and certain officers of the State of Nebraska, constituting *ex officio* the state board of transportation of that state, and the three secretaries of said board, to enjoin the enforcement of certain rates of transportation fixed by an act of the Nebraska legislature passed April 12, 1893, to go into effect August 1, 1893, on the ground that it was repugnant to the constitution of the United States. The board of transportation had been established by a former act, with authority to inquire into the management of the business of all common carriers, to compel attendance and testimony of witnesses, production of books, papers, documents, and for the purpose could invoke the aid of the state courts to compel attendance subject to penalty as for contempt, and evidence could not be withheld, though it might tend to criminate the witness, but should not be used against him. The constitution provided that "the legislature may from time to time pass laws establishing reasonable maximum rates of charges for the transportation of passengers and freight on the railroads in this state."

The act of 1893 provided that all freight to be transported from one point in the state to another therein shall be classified as in the act designated and set forth in detail, and any other classification was prohibited and made unlawful. The act also fixed a schedule of rates for distances specified in detail upon the classes of freight mentioned, and said "any higher or greater rate for the distance hauled than that herein fixed and established is prohibited and declared to be unlawful." The board of transportation was clothed with authority to reduce rates and enforce the same, but not to raise them above those fixed in the act, whenever it should deem it reasonable and just to do so, upon giving certain public notice; articles not mentioned should be classed with analogous articles, and charged like rates. If any railroad company could show that the rates established would be unjust and unreasonable to it, upon complaint made to the supreme

<sup>1</sup> Statement abridged; part of opinion and arguments omitted. The case was argued by Mr. W. J. Bryan, Mr. John L. Webster, for appellants, and by Mr. J. M. Woodworth and Mr. James C. Carter, for appellees.

court, in which the fullest disclosure of all matters pertaining to its property and business in detail should be made, the court might increase rates upon that road to a sum not greater than those rates charged by such company January 1, 1893. All violations of the act by any carrier, either by commission or omission, made the same liable to any one damaged, including costs and attorney's fees, and to fines of from \$1,000 to \$25,000—in each case the parties to have right of trial by jury. The decision of the court below—the circuit court of the United States for the district of Nebraska—Mr. Justice Brewer presiding, was for the complainants, and the defendants were permanently enjoined from carrying out the provisions of the act, on the ground that it violated the constitution of the United States. The board of transportation brought this appeal. 64 Fed. Rep. 165.]

MR. JUSTICE HARLAN (after disposing of some preliminary questions). \* \* \* We are now to inquire whether the Nebraska statute is repugnant to the constitution of the United States.

By the fourteenth amendment it is provided that no state shall deprive any person of property without due process of law, nor deny to any person within its jurisdiction the equal protection of the laws. That corporations are persons within the meaning of this amendment is now settled. *Santa Clara County v. Southern Pacific Railroad*, 118 U. S. 394, 396; *Charlotte, Columbia and Augusta Railroad v. Gibbes*, 142 U. S. 386, 391; *Gulf, Colorado and Santa Fe Railway v. Ellis*, 165 U. S. 150, 154. What amounts to deprivation of property without due process of law or what is a denial of the equal protection of the laws is often difficult to determine, especially where the question relates to the property of a *quasi*-public corporation and the extent to which it may be subjected to public control. But this court, speaking by Chief Justice Waite, has said that, while a state has power to fix the charges by railroad companies for the transportation of persons and property within its own jurisdiction, unless restrained by valid contract, or unless what is done amounts to a regulation of foreign or interstate commerce, such power is not without limit; and that, “under pretense of regulating fares and freights, the state can not require a railroad corporation to carry persons or property without reward, neither can it do that which in law amounts to the taking of private property for public use without just compensation, or without due process of law.” *Railroad Commission Cases*, 116 U. S. 307, 325, 331. This principle was recognized in *Dow v. Beidelman*, 125 U. S. 680, 689, and has been reaffirmed in other cases.

In *Georgia Railroad and Banking Company v. Smith*, 128 U. S. 174, 179, it was said that the power of the state to prescribe the charges of a railroad company for the carriage of persons and merchandise within its limits—in the absence of any provision in the charter of the company constituting a contract vesting it with authority over those matters—was “subject to the limitation that the carriage is not required without reward, or upon conditions amounting to the taking of property for public use without just compensation, and that

what is done does not amount to a regulation of foreign or interstate commerce." In *Chicago, Milwaukee and St. Paul Railway v. Minnesota*, 134 U. S. 418, 458, it was said: "If the company is deprived of the power of charging reasonable rates for the use of its property, and such deprivation takes place in the absence of an investigation by judicial machinery, it is deprived of the lawful use of its property, and thus, in substance and effect, of the property itself, without due process of law and in violation of the constitution of the United States, and in so far as it is thus deprived, while other persons are permitted to receive reasonable profits upon their invested capital, the company is deprived of the equal protection of the laws." In *Chicago and Grand Trunk Railway v. Wellman*, 143 U. S. 339, 344, the court, in answer to the suggestion that the legislature had no authority to prescribe maximum rates for railroad transportation, said that "the legislature has power to fix rates, and the extent of judicial interference is protection against unreasonable rates." In *Budd v. New York*, 143 U. S. 517, 547, the court, while sustaining the power of New York by statute to regulate charges to be exacted at grain elevators and warehouses in that state, took care to state, as a result of former decisions, that such power was not one "to destroy or a power to compel the doing of the services without reward, or to take private property for public use without just compensation or without due process of law."

In *Reagan v. Farmers' Loan and Trust Co.*, 154 U. S. 362, 399, which involved the validity of certain rates for freights and passengers prescribed by a railroad commission established by an act of the legislature of Texas, this court, after referring to the above cases, said: "These cases all support the proposition that while it is not the province of the courts to enter upon the merely administrative duty of framing a tariff of rates for carriage, it is within the scope of judicial power and a part of judicial duty to restrain anything which, in the form of a regulation of rates, operates to deny to the owners of property invested in the business of transportation that equal protection which is the constitutional right of all owners of other property. There is nothing new or strange in this. It has always been a part of the judicial function to determine whether the act of one party (whether that party be a single individual, an organized body or the public as a whole) operates to divest the other party of any rights of person or property. In every constitution is the guarantee against the taking of private property for public purposes without just compensation. The equal protection of the laws, which, by the fourteenth amendment, no state can deny to the individual, forbids legislation, in whatever form it may be enacted, by which the property of one individual is, without compensation, wrested from him for the benefit of another, or of the public. This, as has been often observed, is a government of law, and not a government of men, and it must never be forgotten that under such a government, with its constitutional limitations and guarantees, the forms of law and the machinery of government, with all their reach and power, must, in their actual work-

ings, stop on the hither side of the unnecessary and uncompensated taking or destruction of any private property, legally acquired and legally held. It was, therefore, within the competency of the circuit court of the United States for the western district of Texas, at the instance of the plaintiff, a citizen of another state, to enter upon an inquiry as to the reasonableness and justice of the rates prescribed by the railroad commission. Indeed, it was in so doing only exercising a power expressly named in the act creating the commission."

So, in *St. Louis and San Francisco Railway v. Gill*, 156 U. S. 649, 657, it was said that "there is a remedy in the courts for relief against legislation establishing a tariff of rates which is so unreasonable as to practically destroy the value of property of companies engaged in the carrying business, and that especially may the courts of the United States treat such a question as a judicial one, and hold such acts of legislation to be in conflict with the constitution of the United States, as depriving the companies of their property without due process of law, and as depriving them of the equal protection of the laws." In *Covington and Lexington Turnpike Road Co. v. Sandford*, 164 U. S. 578, 584, 594, 595, 597, which involved the validity of a state enactment prescribing rates of toll on a turnpike road, the court said: "A statute which, by its necessary operation, compels a turnpike company, when charging only such tolls as are just to the public, to submit to such further reduction of rates as will prevent it from keeping its road in proper repair, and from earning any dividends whatever for stockholders, is as obnoxious to the constitution of the United States as would be a similar statute relating to the business of a railroad corporation having authority, under its charter, to collect and receive tolls for passengers and freight." And in *Chicago, Burlington and Quincy Railroad v. Chicago*, 166 U. S. 226, 241, it was held that "a judgment of a state court, even if it be authorized by statute, whereby private property is taken for the state or under its direction for public use, without compensation made or secured to the owner, is, upon principle and authority, wanting in the due process of law required by the fourteenth amendment of the constitution of the United States, and the affirmance of such judgment by the highest court of the state is a denial by that state of a right secured to the owner by that instrument."

In view of the adjudications these principles must be regarded as settled:

1. A railroad corporation is a person within the meaning of the fourteenth amendment, declaring that no state shall deprive any person of property without due process of law, nor deny to any person within its jurisdiction the equal protection of the laws.

2. A state enactment, or regulations made under the authority of a state enactment, establishing rates for the transportation of persons or property by railroad that will not admit of the carrier earning such compensation as under all the circumstances is just to it and to the public, would deprive such carrier of its property without due process of law and deny to it the equal protection of the laws, and would,

therefore, be repugnant to the fourteenth amendment of the constitution of the United States.

3. While rates for the transportation of persons and property within the limits of a state are primarily for its determination, the question whether they are so unreasonably low as to deprive the carrier of its property without such compensation as the constitution secures, and, therefore, without due process of law, can not be so conclusively determined by the legislature of the state or by regulations adopted under its authority, that the matter may not become the subject of judicial inquiry.

The cases before us directly present the important question last stated.

Before entering upon its examination, it may be observed that the grant to the legislature in the constitution of Nebraska of the power to establish maximum rates for the transportation of passengers and freight on railroads in that state has reference to "reasonable" maximum rates. These words strongly imply that it was not intended to give a power to fix maximum rates without regard to their reasonableness. Be this as it may, it can not be admitted that the power granted may be exerted in derogation of rights secured by the constitution of the United States, or that the judiciary may not, when its jurisdiction is properly invoked, protect those rights.

What are the considerations to which weight must be given when we seek to ascertain the compensation that a railroad company is entitled to receive, and a prohibition upon the receiving of which may be fairly deemed a deprivation by legislative decree of property without due process of law? Undoubtedly that question could be more easily determined by a commission composed of persons whose special skill, observation and experience qualifies them to so handle great problems of transportations as to do justice both to the public and to those whose money has been used to construct and maintain highways for the convenience and benefit of the people. But despite the difficulties that confessedly attend the proper solution of such questions, the court can not shrink from the duty to determine whether it be true, as alleged, that the Nebraska statute invades or destroys rights secured by the supreme law of the land. No one, we take it, will contend that a state enactment is in harmony with that law simply because the legislature of the state has declared such to be the case, for that would make the state legislature the final judge of the validity of its enactment, although the constitution of the United States and the laws made in pursuance thereof are the supreme law of the land, anything in the constitution or laws of any state to the contrary notwithstanding. Article VI. The idea that any legislature, state or federal, can conclusively determine for the people and for the courts that what it enacts in the form of law, or what it authorizes its agents to do, is consistent with the fundamental law, is in opposition to the theory of our institutions. The duty rests upon all courts, federal and state, when their jurisdiction is properly invoked, to see to it that no right secured by the supreme law of the land is impaired or

destroyed by legislation. This function and duty of the judiciary distinguishes the American system from all other systems of government. The perpetuity of our institutions and the liberty which is enjoyed under them depend, in no small degree, upon the power given the judiciary to declare null and void all legislation that is clearly repugnant to the supreme law of the land.

We turn now to the evidence in the voluminous record before us for the purpose of ascertaining whether—looking at the cases in the light of the facts as they existed when the decrees were rendered—the Nebraska statute, if enforced, would, by its necessary operation, have deprived the companies, whose stockholders and bondholders here complain, of the right to obtain just compensation for the services rendered by them.

The first and most important contention of the plaintiffs is that, if the statute had been in force during any one of the three years preceding its passage, the defendant companies would have been compelled to use their property for the public substantially without reward or without the just compensation to which it was entitled. We think this mode of calculation for ascertaining the probable effect of the Nebraska statute upon the railroad companies in question is one that may be properly used.

The conclusion reached by the circuit court was that the reduction made by the Nebraska statute in the rates for local freight was so unjust and unreasonable as to require a decree staying the enforcement of such rates against the companies named in the bill. *Ames v. Union Pacific Railway*, 64 Fed. Rep. 165, 189. That conclusion was based largely upon the figures presented by Mr. Dilworth, while he was a secretary of the state board of transportation, as well as a defendant and one of the solicitors of the defendants in these causes. He was a principal witness for that board. His general fairness and his competency to speak of the facts upon which the question before us depends are apparent on the record. He stated that the average reduction made by the statute on all the "commodities of local rates" was 29.50 per cent., and this estimate seems to have been accepted by the parties as correct. He estimated that the percentage of operating expenses on local business would exceed the percentage of operating expenses on all business by at least 10 per cent., and that it might go as high as 20 per cent. or higher. And this view is more than sustained by the evidence of witnesses possessing special knowledge of railroad transportation and of the cost of doing local business as compared with what is called through business. Indeed, one of those witnesses states that the cost of carrying local freight is four times as much as the cost of through freight per ton per mile; another, that the cost of the short haul is "reasonably double the long haul." If due regard be had to the testimony—and we have no other basis for our judgment—we are not permitted to place the extra cost of local business at less than 10 per cent. greater than the percentage of the cost of all business.

In answer to questions propounded to him by the defendants con-



stituting the state board of transportation, Mr. Dilworth stated that he had prepared himself with an estimate showing the number of tons of freight, commonly spoken of as local freight, hauled on the respective railways in Nebraska, and the amount received by the railway companies by way of tariff on tons of freight hauled, including through as well as local freight, and was qualified to speak as to the amount received by the companies for both passengers and freight within the state, and the reduction that would take place in rates under the statute in question. He presented various tables showing the results of his investigations. \* \* \*

[Here follow tables, showing in detail percentages of earnings to operating expenses upon the various roads, tons of local freight hauled, amount received per mile for the same, reduction the new law would cause, etc.]

In view of the reduction of 29.50 in rates prescribed by the statute and of the extra cost of doing local business, as compared with other business, what do these facts show?

Take the case of the Burlington road from July 1, 1890, to June 30, 1891. Looking at the entire business done on it during that period within the limits of the state, we find that the percentage of operating expenses to earnings on all business—which, as stated, does not include the extra cost of local business—was 66.24. Add to this the extra cost of local business, estimated, at at least ten per cent., and the result is that, under the rates charged during the period stated, the cost to the Burlington Company of earning \$100 would have been \$76.24. Now, if the reduction of 29½ per cent. made by the act of 1893 had been in force prior to July 1, 1891, the company would have received \$70.50 as against \$100 for the same service, showing that in that year the operating expenses would have exceeded the earnings by \$5.74 in every \$100 of the amount actually received by it. \* \* \*

Under the rates prescribed by the act of 1893 the cost to the respective companies of local business in Nebraska would have exceeded the earnings for the years ending June 30, 1891, 1892 and 1893, respectively, in every one hundred dollars of the amount actually received, as follows: To the Burlington Company, by \$5.74, \$3.73 and \$5.01; to the St. Paul Company, by \$10.28, \$5.46 and \$4.08; to the Omaha Company, by \$59.76, \$32.62 and \$33.64; to the St. Joseph Company, by \$35.94, \$13.73 and \$1.55; and to the Kansas City Company, by \$39.04, \$14.69 and \$16.00. The cost to the Union Pacific Company for the year ending June 30, 1891, of its local business, under the rates prescribed by the statute of 1893, would have caused a loss of \$8.44 in every one hundred dollars of the amount actually received. \* \* \*

There are other views of the case suggested by the above exhibits and table which show the same results.

In the year ending June 30, 1891, under the rates then in force, the Burlington Company received \$1,066,871 for tons carried locally. If the business had been done under the rates prescribed by the act of 1893, it would have received 29½ per cent. less, that is, only \$752,-

145 or \$314,726 less than it did receive. The percentage of expenses to earnings, including the extra cost of local business, was \$76.24; that is, it cost \$813,382 to earn \$1,066,871. So that the difference between \$813,382 and \$752,145 shows that, if the rates prescribed by the statute of 1893 had been in force during the year ending June 30, 1891, the amount received would have been less than the operating expenses of the Burlington Company by \$61,237. \* \* \*

[Like calculations show a similar loss to this company in 1892, of \$46,172; and in 1893 of \$62,243.]

By the same mode of calculation, it would be found that, if the statute of 1893 had been enforced during the years ending the 30th days of June, 1891, 1892 and 1893, respectively, the other companies would have lost, that is, their expenses would have exceeded their earnings during those years by the following amounts: The St. Paul Company, \$11,403; \$6,716 and \$5,814; the Fremont Company, \$34,377 for the year ending June 30, 1892; the Union Pacific Company, \$23,480, for the year ending June 30, 1891; the Omaha Company, \$45,166, \$28,813 and \$27,085; the St. Joseph Company, \$7,840, \$4,256 and \$523; and the Kansas City Company, \$2,627, \$974 and \$1,510; while the earnings of the Union Pacific Company would have exceeded its expenses for the years ending the 30th days of June, 1892 and 1893, respectively, by \$16,170 and \$8,234, and those of the Fremont Company by \$37,037 and \$29,036 for the years ending the 30th days of June, 1891 and 1893, respectively. \* \* \*

It is further said, in behalf of the appellants, that the reasonableness of the rates established by the Nebraska statute is not to be determined by the inquiry whether such rates would leave a reasonable net profit from the local business affected thereby, but that the court should take into consideration, among other things, the whole business of the company, that is, all its business, passenger and freight, interstate and domestic. If it be found upon investigation that the profits derived by a railroad company from its interstate business alone are sufficient to cover operating expenses on its entire line, and also to meet interest and justify a liberal dividend upon its stock, may the legislature prescribe rates for domestic business that would bring no reward and be less than the services rendered are reasonably worth? Or, must the rates for such transportation as begins and ends in the state be established with reference solely to the amount of business done by the carrier wholly within such state, to the cost of doing such local business, and to the fair value of the property used in conducting it, without taking into consideration the amount and cost of its interstate business and the value of the property employed in it? If we do not misapprehend counsel, their argument leads to the conclusion that the state of Nebraska could legally require local freight business to be conducted even at an actual loss if the company earned on its interstate business enough to give it just compensation in respect of its entire line and all its business, interstate and domestic. We can not concur in this view. In our judgment it must be held that the reasonableness or unreasonableness of rates prescribed by a state for the

transportation of persons and property wholly within its limits must be determined without reference to the interstate business done by the carrier, or to the profits derived from it. The state can not justify unreasonably low rates for domestic transportation, considered alone, upon the ground that the carrier is earning large profits on its interstate business, over which, so far as rates are concerned, the state has no control. Nor can the carrier justify unreasonably high rates on domestic business upon the ground that it will be able only in that way to meet losses on its interstate business. So far as rates of transportation are concerned, domestic business should not be made to bear the losses on interstate business, nor the latter the losses on domestic business. It is only rates for the transportation of persons and property between points within the state that the state can prescribe; and when it undertakes to prescribe rates not to be exceeded by the carrier, it must do so with reference exclusively to what is just and reasonable, as between the carrier and the public, in respect of domestic business. The argument that a railroad line is an entirety; that its income goes into, and its expenses are provided for out of, a common fund; and that its capitalization is on its entire line, within and without the state, can have no application where the state is without authority over rates on the entire line, and can only deal with local rates and make such regulations as are necessary to give just compensation on local business. \* \* \*

It appears, from what has been said, that if the rates prescribed by the act of 1893 had been in force during the years ending June 30, 1891, 1892 and 1893, the Fremont Company, in the years ending June 30, 1891, and June 30, 1893, and the Union Pacific Company, in the years ending June 30, 1892, and June 30, 1893, would each have received more than enough to pay operating expenses. Do those facts affect the general conclusion as to the probable effect of the act of 1893? In the discussion of this question, the plaintiffs contended that a railroad company is entitled to exact such charges for transportation as will enable it, at all times, not only to pay operating expenses, but also to meet the interest regularly accruing upon all its outstanding obligations, and justify a dividend upon all its stock; and that to prohibit it from maintaining rates or charges for transportation adequate to *all* those ends will deprive it of its property without due process of law, and deny to it the equal protection of the laws. This contention was the subject of elaborate discussion; and, as it bears upon each case in its important aspects, it should not be passed without examination.

In our opinion, the broad proposition advanced by counsel involves some misconception of the relations between the public and a railroad corporation. It is unsound, in that it practically excludes from consideration the fair value of the property used, omits altogether any consideration of the right of the public to be exempt from unreasonable exactions, and makes the interests of the corporation maintaining a public highway the sole test in determining whether the rates established by or for it are such as may be rightfully prescribed as be-

tween it and the public. A railroad is a public highway, and none the less so because constructed and maintained through the agency of a corporation deriving its existence and powers from the state. Such a corporation was created for public purposes. It performs a function of the state. Its authority to exercise the right of eminent domain and to charge tolls was given primarily for the benefit of the public. It is under governmental control, though such control must be exercised with due regard to the constitutional guarantees for the protection of its property. *Olcott v. The Supervisor*, 16 Wall. 678, 694; *Sinking Fund Cases*, 99 U. S. 700, 719; *Cherokee Nation v. Southern Kansas Railway*, 135 U. S. 641, 657. It can not, therefore, be admitted that a railroad corporation maintaining a highway under the authority of the state may fix its rates with a view solely to its own interests, and ignore the rights of the public. But the rights of the public would be ignored if rates for the transportation of persons or property on a railroad are exacted without reference to the fair value of the property used for the public or the fair value of the services rendered, but in order simply that the corporation may meet operating expenses, pay the interest on its obligations, and declare a dividend to stockholders.

If a railroad corporation has bonded its property for an amount that exceeds its fair value, or if its capitalization is largely fictitious, it may not impose upon the public the burden of such increased rates as may be required for the purpose of realizing profits upon such excessive valuation or fictitious capitalization; and the apparent value of the property and franchises used by the corporation, as represented by its stocks, bonds and obligations, is not alone to be considered when determining the rates that may be reasonably charged. What was said in *Covington and Lexington Turnpike Road Co. v. Sandford*, 164 U. S. 578, 596, 597, is pertinent to the question under consideration. . It was there observed: "It can not be said that a corporation is entitled, as of right, and without reference to the interests of the public, to realize a given per cent. upon its capital stock. When the question arises whether the legislature has exceeded its constitutional power in prescribing rates to be charged by a corporation controlling a public highway, stockholders are not the only persons whose rights or interests are to be considered. The rights of the public are not to be ignored. It is alleged here that the rates prescribed are unreasonable and unjust to the company and its stockholders. But that involves an inquiry as to what is reasonable and just for the public. \* \* \* The public can not properly be subjected to unreasonable rates in order simply that stockholders may earn dividends. The legislature has the authority, in every case, where its power has not been restrained by contract, to proceed upon the ground that the public may not rightfully be required to submit to unreasonable exactions for the use of a public highway established and maintained under legislative authority. If a corporation can not maintain such a highway and earn dividends for stockholders, it is a misfortune for it and them

which the constitution does not require to be remedied by imposing unjust burdens upon the public. So that the right of the public to use the defendant's turnpike upon payment of such tolls as in view of the nature and value of the services rendered by the company are reasonable, is an element in the general inquiry whether the rates established by law are unjust and unreasonable."

A corporation maintaining a public highway, although it owns the property it employs for accomplishing public objects, must be held to have accepted its rights, privileges and franchises subject to the condition that the government creating it, or the government within whose limits it conducts its business, may by legislation protect the people against unreasonable charges for the services rendered by it. It can not be assumed that any railroad corporation, accepting franchises, rights and privileges at the hands of the public, ever supposed that it acquired, or that it was intended to grant to it, the power to construct and maintain a public highway simply for its benefit, without regard to the rights of the public. But it is equally true that the corporation performing such public services and the people financially interested in its business and affairs have rights that may not be invaded by legislative enactment in disregard of the fundamental guarantees for the protection of property. The corporation may not be required to use its property for the benefit of the public without receiving just compensation for the services rendered by it. How such compensation may be ascertained, and what are the necessary elements in such an inquiry, will always be an embarrassing question. As said in the case last cited: "Each case must depend upon its special facts; and when a court, without assuming itself to prescribe rates, is required to determine whether the rates prescribed by the legislature for a corporation controlling a public highway are, as an entirety, so unjust as to destroy the value of its property for all the purposes for which it was acquired, its duty is to take into consideration the interests both of the public and of the owner of the property, together with all other circumstances that are fairly to be considered in determining whether the legislature has, under the guise of regulating rates, exceeded its constitutional authority, and practically deprived the owner of property without due process of law. \* \* \* The utmost that any corporation operating a public highway can rightfully demand at the hands of the legislature, when exerting its general powers, is that it receive what, under all the circumstances, is such compensation for the use of its property as will be just both to it and to the public."

We hold, however, that the basis of all calculations as to the reasonableness of rates to be charged by a corporation maintaining a highway under legislative sanction must be the fair value of the property being used by it for the convenience of the public. And in order to ascertain that value, the original cost of construction, the amount expended in permanent improvements, the amount and market value of its bonds and stock, the present as compared with the original cost of construction, the probable earning capacity of the prop-



erty under particular rates prescribed by statute, and the sum required to meet operating expenses, are all matters for consideration, and are to be given such weight as may be just and right in each case. We do not say that there may not be other matters to be regarded in estimating the value of the property. What the company is entitled to ask is a fair return upon the value of that which it employs for the public convenience. On the other hand, what the public is entitled to demand is that no more be exacted from it for the use of a public highway than the services rendered by it are reasonably worth. But even upon this basis, and determining the probable effect of the act of 1893 by ascertaining what could have been its effect if it had been in operation during the three years immediately preceding its passage, we perceive no ground on the record for reversing the decree of the circuit court. On the contrary, we are of opinion that as to most of the companies in question there would have been, under such rates as were established by the act of 1893, an actual loss in each of the years ending June 30, 1891, 1892 and 1893; and that, in the exceptional cases above stated, when two of the companies would have earned something above operating expenses, in particular years, the receipts or gains, above operating expenses, would have been too small to affect the general conclusion that the act, if enforced, would have deprived each of the railroad companies involved in these suits of the just compensation secured to them by the constitution. Under the evidence there is no ground for saying that the operating expenses of any of the companies were greater than necessary. \* \* \*

*Affirmed.*

See note at end of the next case.

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Sec. 437. Same.

(c.) Requiring reports.

#### EAGLE INSURANCE COMPANY v. OHIO.<sup>1</sup>

1894. IN THE SUPREME COURT OF THE UNITED STATES. 153 U. S. Rep. 446-456.

[Error to the supreme court of Ohio. The insurance company, plaintiff in error, was incorporated in 1850 by a special act of the Ohio legislature, without reserving the right to repeal or amend the same. Afterward, sections 3654, 3655, of the Revised Statutes of Ohio, were enacted, requiring all insurance companies to make full and specified returns in detail to designated state officers, of their business condition, liabilities, losses, premiums, taxes, dividends, expenses, etc., upon blanks furnished by such officers. Blanks were duly

<sup>1</sup>Statement abridged, and small part of the opinion omitted. The charter in full, and the details of the items to be reported, are given in the report on pp. 446-452.



furnished, and upon refusal by the company to make the required returns, mandamus proceedings were begun, and upon hearing, the supreme court issued a peremptory writ. Error was brought on the ground that the law impaired the obligation of the charter contract.]

MR. JUSTICE WHITE. The only question presented is whether or not the charter of the plaintiff in error exempted it from obligation to comply with the subsequently established police regulations of the state, contained in sections 3654 and 3655 of the Revised Statutes of Ohio. This subject was fully considered by this court in the case of *The Chicago Life Insurance Company v. Needles*, 113 U. S. 574. There the company had been chartered by the state of Illinois to carry on a life insurance business, and the question was whether subsequently enacted police regulations of that state for the inspection of such business, and for the liquidation thereof, in the event of insolvency, could be enforced against a corporation working under a prior charter without impairing the obligation of the contract. The statute considered in the *Needles Case* authorized the auditor, whenever the actual funds of any life insurance company doing business in the state were not of a net value equal to the net value of its policies, according to the "combined experience" or "actuaries'" rate of mortality, with interest at four per cent., to give notice to such company and its agent to discontinue issuing policies in the state until such time as its funds should become equal to its liabilities, valuing its policies as aforesaid. The law, in addition, required every life insurance company incorporated in Illinois to transmit to the auditor, on or before the 1st day of March in each year, a sworn statement of its business, standing and affairs, in the form prescribed and authorized by law. It also empowered the officer to address inquiries to any company in relation to its "doings and condition," and any other matter connected with its transactions, which inquiries, it provided, should be "promptly answered;" and it imposed upon him the duty of making an examination of the condition and affairs of any company, whenever he deemed it expedient to do so, and had reason to suspect the correctness of any annual statement, or that the company was in an unsound condition. By another statute it was provided that if, upon examination of the affairs of any insurance company, the auditor should conclude that it was insolvent, or that its further continuance in business would be hazardous to the insured or the public, he should apply by petition to the judge of any circuit court for an injunction restraining the company from proceeding with its business until further hearing, etc. Upon the case as thus presented, the court said:

"The case upon the merits, so far as they involve any question of which this court may take cognizance, is within a very narrow compass. The main proposition of the counsel is that the obligation of the contract which the company had with the state in its original and amended charter will be impaired if that company be held subject to the operation of subsequent statutes regulating the business of life insurance and authorizing the courts, in certain contingencies, to suspend, restrain or prohibit insurance companies incorporated in Illinois

from further continuance in business. This position can not be sustained consistently with the power which the state has, and, upon every ground of public policy, must always have, over corporations of her own creation. Nor is it justified by any reasonable interpretation of the language of the company's charter. The right of the plaintiff in error to exist as a corporation, and its authority, in that capacity, to conduct the particular business for which it was created were granted, subject to the condition that the privileges and franchises conferred upon it should not be abused, or so employed as to defeat the ends for which it was established, and that, when so abused or misemployed, they might be withdrawn or reclaimed by the state in such way and by such modes of procedure as were consistent with law. Although no such condition is expressed in the company's charter, it is necessarily implied in every grant of corporate existence. *Terrett v. Taylor*, 9 Cranch 43, 51; *Angell & Ames on Corporations*, 9th ed., paragraph 774, note.

"Equally implied, in our judgment, is the condition that the corporation shall be subject to such reasonable regulations, in respect to the general conduct of its affairs, as the legislature may from time to time prescribe, which do not materially interfere with or obstruct the substantial enjoyment of the privileges the state has granted, and serve only to secure the ends for which the corporation was created. *Sinking Fund Cases*, 99 U. S. 700; *Commonwealth v. Farmers' and Mechanics' Bank*, 21 Pick. 542; *Commercial Bank v. Mississippi*, 4 Sm. & Marsh. 497, 503. If this condition be not necessarily implied, then the creation of corporations, with rights and franchises which do not belong to individual citizens, may become dangerous to the public welfare through the ignorance, or misconduct, or fraud of those to whose management their affairs are entrusted. It would be extraordinary if the legislative department of a government, charged with the duty of enacting such laws as may promote the health, the morals, and the prosperity of the people, might not, when unrestrained by constitutional limitations upon its authority, provide, by reasonable regulations, against the misuse of special corporate privileges which it has granted, and which could not, except by its sanction, express or implied, have been exercised at all."

These views are decisive of the issue here. An attempt is made to distinguish that case from this upon the ground that, in the former, the proceedings were for the purpose of compelling the company to cease from business because of insolvency; while, in this case, the question is as to the obligation of the company to make the statements required by the statute. This distinction is without foundation. In the *Needles Case*, the duty was expressly imposed upon the corporation to make statements identical in form and substance with those which insurance companies are required to make under the Ohio statute we are here considering. Many additional police powers were conferred by the Illinois law, among them being the authority which, as stated above, was given to the state auditor to apply for an injunction restraining a company from continuing its business, whenever, by

furnished, and upon refusal by the company to make the required returns, mandamus proceedings were begun, and upon hearing, the supreme court issued a peremptory writ. Error was brought on the ground that the law impaired the obligation of the charter contract.]

MR. JUSTICE WHITE. The only question presented is whether or not the charter of the plaintiff in error exempted it from obligation to comply with the subsequently established police regulations of the state, contained in sections 3654 and 3655 of the Revised Statutes of Ohio. This subject was fully considered by this court in the case of *The Chicago Life Insurance Company v. Needles*, 113 U. S. 574. There the company had been chartered by the state of Illinois to carry on a life insurance business, and the question was whether subsequently enacted police regulations of that state for the inspection of such business, and for the liquidation thereof, in the event of insolvency, could be enforced against a corporation working under a prior charter without impairing the obligation of the contract. The statute considered in the *Needles Case* authorized the auditor, whenever the actual funds of any life insurance company doing business in the state were not of a net value equal to the net value of its policies, according to the "combined experience" or "actuaries'" rate of mortality, with interest at four per cent., to give notice to such company and its agent to discontinue issuing policies in the state until such time as its funds should become equal to its liabilities, valuing its policies as aforesaid. The law, in addition, required every life insurance company incorporated in Illinois to transmit to the auditor, on or before the 1st day of March in each year, a sworn statement of its business, standing and affairs, in the form prescribed and authorized by law. It also empowered the officer to address inquiries to any company in relation to its "doings and condition," and any other matter connected with its transactions, which inquiries, it provided, should be "promptly answered;" and it imposed upon him the duty of making an examination of the condition and affairs of any company, whenever he deemed it expedient to do so, and had reason to suspect the correctness of any annual statement, or that the company was in an unsound condition. By another statute it was provided that if, upon examination of the affairs of any insurance company, the auditor should conclude that it was insolvent, or that its further continuance in business would be hazardous to the insured or the public, he should apply by petition to the judge of any circuit court for an injunction restraining the company from proceeding with its business until further hearing, etc. Upon the case as thus presented, the court said:

"The case upon the merits, so far as they involve any question of which this court may take cognizance, is within a very narrow compass. The main proposition of the counsel is that the obligation of the contract which the company had with the state in its original and amended charter will be impaired if that company be held subject to the operation of subsequent statutes regulating the business of life insurance and authorizing the courts, in certain contingencies, to suspend, restrain or prohibit insurance companies incorporated in Illinois

from further continuance in business. This position can not be sustained consistently with the power which the state has, and, upon every ground of public policy, must always have, over corporations of her own creation. Nor is it justified by any reasonable interpretation of the language of the company's charter. The right of the plaintiff in error to exist as a corporation, and its authority, in that capacity, to conduct the particular business for which it was created were granted, subject to the condition that the privileges and franchises conferred upon it should not be abused, or so employed as to defeat the ends for which it was established, and that, when so abused or misemployed, they might be withdrawn or reclaimed by the state in such way and by such modes of procedure as were consistent with law. Although no such condition is expressed in the company's charter, it is necessarily implied in every grant of corporate existence. *Terrett v. Taylor*, 9 Cranch 43, 51; *Angell & Ames on Corporations*, 9th ed., paragraph 774, note.

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its statement, it appeared to him to be insolvent. It is, indeed, true that the relief there invoked was the restraint of the corporation from doing business on the ground of insolvency. But that case substantially involved not only the right to compel the statement, but the greater right to prevent, in case of insolvency, the continuance of the business of the corporation. Hence, as the greater includes the less, the Needles Case necessarily embraces every issue presented here. \* \* \*

*Affirmed.*

*Note. Police power.<sup>1</sup>*

1. *Definition and general extent:* Mr. Justice Field, in 1885, *Barbier v. Connolly*, 113 U. S. 27, on 31, defines this as "the power to prescribe regulations to promote the *health, peace, morals, education and good order* of the people, and to legislate so as to increase the industries of the state, develop its resources, and add to its wealth and prosperity." See, also, *Thorpe v. R. & B. R. Co.*, 27 Vt. 140, *supra*, p. 1344; 1893, *Virginia Development Co. v. Crozier Iron Co.*, 90 Va. 126, 129; 1897, *Holden v. Hardy*, 169 U. S. 366.

This power is so necessary and so important that the state can not, even by express legislation, bargain it away or divest itself of it: 1850, *Phalen v. Virginia*, 8 How. 163, 168; 1879, *Stone v. Mississippi*, 101 U. S. 814, *supra*, p. 1348; 1886, *Stone v. Farmers' L. & T. Co.*, 116 U. S. 307; 1896, *Commonwealth v. Douglass*, 100 Ky. 116, 66 Am. St. Rep. 328; 1897, *Douglass v. Kentucky*, 168 U. S. 488.

Such a power, as Mr. Justice Miller says, is "from its very nature incapable of any very exact definition or limitation"—*Slaughter-House Cases*, 16 Wall. 36, 62 (1872); its limits have not been defined with precision, but they are determined by the "gradual process of judicial inclusion and exclusion"—*Post, C. J.*, in, 1896, *Chicago, etc., R. Co. v. State*, 47 Neb. 549, 53 Am. St. Rep. 557, on 565.

While upon the one hand constitutional rights can not be abridged by legislation under the guise of police regulation, as the right to engage or refuse to engage in any lawful business or enterprise: 1888, *People v. Gillson*, 109 N. Y. 389, 4 Am. St. Rep. 465; 1895, *State v. Julow*, 129 Mo. 163, 50 Am. St. Rep. 443; cf. *Gundling v. Chicago*, 177 U. S. 183; nor can valid contracts be annulled: 1899, *Lake Shore, etc., R. Co. v. Smith*, 173 U. S. 684; 1900, *Stearns v. Minnesota*, 179 U. S. 223; yet upon the other hand the provisions of the 14th amendment of the United States constitution were not "designed to limit the *subjects* upon which the police power of the state may be exerted"—1885, *Barbier v. Connolly*, 113 U. S. 27; 1887, *Mugler v. Kansas*, 123 U. S. 663; 1889, *Minneapolis, etc., R. Co. v. Beckwith*, 129 U. S. 26. The provisions of this amendment, however, do prevent the states, under the guise of the police power, from making unjust discriminations: 1886, *Yick Wo v. Hopkins*, 118 U. S. 356; cf. 1885, *Soon Hing v. Crowley*, 113 U. S. 703, and 1885, *Barbier v. Connolly*, 113 U. S. 27, or taking property, or divesting vested rights without due process of law: 1859, *Commonwealth v. Essex Co.*, 13 Gray (Mass.) 239; 1875, *O. & M. R. Co. v. Lackey*, 78 Ill. 55; 1880, *Detroit v. Det. & H. P. R. Co.*, 43 Mich. 140; 1888, *People v. O'Brien*, 111 N. Y. 1; 1897, *Gulf, Col. & S. F. R. v. Ellis*, 165 U. S. 150; 1898, *Smyth v. Ames*, 169 U. S. 466, *supra*, p. 1352; 1899, *L. S. & M. S. R. Co. v. Smith*, 173 U. S. 684.

The police power of the states is also, to a considerable extent, affected, and in considerable measure limited by the power of congress to regulate interstate and foreign commerce. Here it is settled, in general, "that neither under the guise of inspection nor revenue laws can the states forbid or impede the introduction of products, universally considered harmless": 1890, *Minnesota v. Barber*, 136 U. S. 313; 1891, *Brimmer v. Rebman*, 138 U. S. 78; nor can they burden foreign or interstate commerce by taxation or otherwise, for the purpose of creating discrimination in favor of domestic producers or man-

<sup>1</sup>This note is meant to be only an outline of the cases in which the police power especially affects corporations.



ufacturers: 1849, *Passenger Cases*, 7 How. 283; 1875, *Welton v. Missouri*, 91 U. S. 275; 1875, *Henderson v. New York*, 92 U. S. 259; 1877, *Hannibal & St. J. R. v. Husen*, 95 U. S. 465; 1879, *Guy v. Baltimore*, 100 U. S. 434. As to commerce, see further, below in this note.

2. *Illustrations*: Police laws may provide especially for

(a) The *safety of person and property* by requiring railroad engineers or other employes to be examined for color blindness or other defect of vision: 1888, *Smith v. Alabama*, 124 U. S. 465; 1888, *Nashville, C. & St. L. R. v. Alabama*, 128 U. S. 96; or require railroads to construct fences: 1885, *Missouri Pac. R. Co. v. Humes*, 115 U. S. 512; 1889, *Minnesota, etc., R. Co. v. Beckwith*, 129 U. S. 26; 1893, *Minnesota & St. L. R. v. Emmons*, 149 U. S. 364; or require the abolition of grade crossings and the construction of viaducts over such railroads at the expense of the company: 1885, *State v. Missouri Pac. R.*, 33 Kan. 176; 1894, *N. Y. & N. E. R. Co. v. Bristol*, 151 U. S. 556; 1897, *Wabash R. Co. v. Defiance*, 167 U. S. 88; 1898, *C., B. & Q. R. Co. v. Nebraska*, 170 U. S. 57, or forbid the heating of cars with stoves: 1897, *New York, etc., R. Co. v. New York*, 165 U. S. 628 (citing cases fully, p. 631); or make railroads liable for destruction of property by fire from engines, and require the payment of a reasonable attorney fee as part of the damages: 1897, *St. Louis & S. R. v. Mathews*, 165 U. S. 1 (reviewing cases); 1899, *Atchison, T. & S. F. R. Co. v. Matthews*, 174 U. S. 96 (with list of cases on p. 105); s. c., 43 L. ed. 909, 19 S. Ct. 609; or destroy property to prevent the spread of conflagrations: 1845, *Russell v. Mayor of New York*, 2 Den. (N. Y.) 461; 1851, *Am. Print Works v. Lawrence*, 23 N. J. L. 590.

(b) The *public health and comfort*, by forbidding the introduction of diseased cattle: 1898, *Missouri K. & T. R. Co. v. Haber*, 169 U. S. 613; cf. 1877, *Hannibal & St. J. R. Co. v. Husen*, 95 U. S. 465. Or require the removal of nuisances: 1827, *Coates v. Mayor, etc.*, 7 New York, 7 Cow. (N. Y.) 585; 1878, *Fertilizing Co. v. Hyde Park*, 97 U. S. 659. Or prevent the manufacture and the sale, except in the original package of interstate or foreign commerce, of articles considered injurious to the public welfare, as cigarettes: 1897, *State v. Goetze*, 43 W. Va. 495, 64 Am. St. Rep. 871; 1898, *McGregor v. Cone*, 104 Iowa 465, 65 Am. St. Rep. 522; 1898, *Austin v. State*, 101 Tenn. 563, 70 Am. St. Rep. 703; 1900, *Austin v. Tennessee*, 179 U. S. 343, Adv. Sheets, January 15, 1901, p. 132; or oleomargarine (at least the fraudulent sale of such a product): 1882, *State v. Addington*, 77 Mo. 110; 1885, *People v. Marx*, 99 N. Y. 377; 1887, *People v. Arenberg*, 105 N. Y. 123; 1888, *State v. Marshall*, 64 N. H. 549; 1888, *Waterbury v. Newton*, 50 N. J. L. 534; 1888, *Powell v. Pennsylvania*, 127 U. S. 678; 1888, *Walker v. Pennsylvania*, 127 U. S. 699; 1894, *Plumley v. Mass.*, 155 U. S. 461; 1898, *Schollenberger v. Pennsylvania*, 171 U. S. 1; 1898, *Collins v. New Hampshire*, 171 U. S. 30; or intoxicating liquors: 1873, *Bartemeyer v. Iowa*, 18 Wall. 129; 1877, *Beer Co. v. Massachusetts*, 97 U. S. 25; 1884, *Foster v. Kansas*, 112 U. S. 201; 1886, *Walling v. Michigan*, 116 U. S. 446; 1888, *Bowman v. Chicago & N. W. R.*, 125 U. S. 465; 1890, *Leisy v. Hardin*, 135 U. S. 100; 1891, *In re Rahrer*, 140 U. S. 545, *infra*, p. 1530; 1896, *Scott v. Donald*, 165 U. S. 58. The states can also provide for the protection of health and property by reasonable inspection and quarantine laws.

(See below, in this note).

(c) The *public morals*, by preventing the continuance of lotteries: 1879, *Stone v. Mississippi*, 101 U. S. 814, *supra*, p. 1348; 1886, *New Orleans v. Houston*, 119 U. S. 265; 1897, *Douglas v. Kentucky*, 168 U. S. 488.

(d) The *public comfort, convenience and quiet*, such as stopping trains at cities and towns, delivering telegrams promptly, etc. (see below, in this note).

(e) The *public information*, in regard to the carrying on of business of corporations affecting the public, by requiring reports, as in the case of insurance companies: 1885, *Chicago Life Ins. Co. v. Needles*, 113 U. S. 574; 1894, *Eagle Insurance Co. v. Ohio*, 153 U. S. 446, *supra*, p. 1366; 1898, *Louisville, etc., Co. v. Commonwealth*. — Ky. —, 11 Am. & E. C. C. (N. S.) 201; also in the case of railroad and other quasi-public companies (see below under the next division of this note); 1900, *State v. Express Co.*, 81 Minn. 87, 83 Am. St. R. 366.

(f) The regulation of *public service occupations*: Here those who engage in



an occupation "clothed with a public interest," must serve all who comply with reasonable regulations, without unjust discrimination, and at reasonable rates, which are under the control and regulation of the state, either by requiring reports, fixing rates by direct legislation, or through commissions appointed for the purpose, subject, however, to the limit that such rates must not be so low as to deprive persons of their property without due process of law, the final question as to the reasonableness of rates fixed being a judicial, and not a legislative one. What business is so clothed with a "public interest," is determined by the slow process of "judicial inclusion and exclusion." The following have been held to be such:

- (1) *Associated press* and newsgathering associations: 1900, *Inter-Ocean Pub. Co. v. Assoc. Press*, 184 Ill. 438, 75 Am. St. Rep. 184; *contra*, 159 Mo. 410;
  - (2) *Boards of trade*, and stock exchanges: 1889, *Stock Exchange v. Board of Trade*, 127 Ill. 153, 11 Am. St. Rep. 107;  
*Electric Light*, 1902, *Snell v. Clinton, etc., Co.*, 196 Ill. 626, 89 Am. St. R. 341.
  - (3) *Gas companies*: 1878, *State v. Gas Co.*, 34 Ohio St. 572; 32 Am. Rep. 390; 1889, *Zanesville v. G. L. Co.*, 47 Ohio St. 1. See, *supra*, note on subject of *Mandamus*, p. 1318;
  - (4) *Hacks*: 1888, *Veneman v. Jones*, 118 Ind. 41, 10 Am. St. Rep. 100; 1893, *Lindsay v. Mayor, etc.*, 104 Ala. 261, 53 Am. St. Rep. 44;
  - (5) *Hotels*: 1886, *Bostick v. State*, 47 Ark. 126. See below, No. (10);
  - (6) *Mills*, such as grist and flour: 1866, *Olmstead v. Camp*, 33 Conn. 532, 89 Am. Dec. 221; 1876, *Burlington v. Beasley*, 94 U. S. 310; 1885, *Head v. Amoskeag Mfg. Co.*, 113 U. S. 9; 1893, *State v. Edwards*, 86 Me. 102, 41 Am. St. Rep. 528. See note, 22 Am. Dec. 699;
  - (7) *Railroads*: 1876, *C., B. & Q. R. v. Iowa*, 94 U. S. 155; 1876, *Peik v. C. & N. W. R. Co.*, 94 U. S. 164; 1886, *Railroad Commission Cases*, 116 U. S. 307; 1894, *Reagan v. Farmers' L. & T. Co.*, 154 U. S. 362. As to limits upon the power to fix rates, requiring them to be reasonable and not amount to confiscation, see, 1888, *Georgia R. Co. v. Smith*, 128 U. S. 174, 179; 1889, *Chicago, M. & St. P. R. v. Minn.*, 134 U. S. 418; 1892, *Chicago & G. T. R. v. Wellman*, 143 U. S. 339; 1895, *St. L. & S. F. R. v. Gill*, 156 U. S. 649, 657; 1896, *Covington & L. Tp. Co. v. Sandford*, 164 U. S. 578, 584, 594; 1897, *Chicago, B. & Q. R. v. Chicago*, 166 U. S. 226, 241; 1898, *Smyth v. Ames*, 169 U. S. 466, *supra*, p. 1352; 1899, *L. S. & M. S. R. Co. v. Smith*, 173 U. S. 684. See also especially note 62 Am. St. Rep. 289; also note, *supra*, p. 1318, under *Mandamus*, and below No. (10).
- The state can not make rates to apply outside of the state, or upon goods starting upon a continuous trip from one place in the state and consigned to a place outside: 1886, *Wabash, etc., R. Co. v. Illinois*, 118 U. S. 557. Neither can they violate specific charter provisions: 1891, *Cleveland G. & Co. v. City of Cleveland*, 71 Fed. Rep. 610; 1897, *Central Trust Co. v. Citizens' St. Ry. Co.*, 82 Fed. Rep. 1.
- (8) *Stock yards*: 1897, *Cotting v. Kan. City, etc., Co.*, 82 Fed. Rep. 839.
  - (9) *Telegraph* and *telephone* companies: 1883, *West. Union Tel. Co. v. Pendleton*, 95 Ind. 12, 48 Am. Rep. 692; 1885, *Webster Tel. Case*, 17 Neb. 126; 1885, *Hockett v. State*, 105 Ind. 250, 55 Am. Rep. 201; 1885, *Central U. Tel. Co. v. Bradbury*, 106 Ind. 1; 1886, *Chesapeake & P. Tel. Co. v. B. & O. R. Co.*, 66 Md. 399; 1888, *Cent. U. Tel. Co. v. State*, 118 Ind. 194, 10 Am. St. Rep. 114; 1888, *Commercial Union Tel. Co. v. N. E. Tel. Co.*, 61 Vt. 241, 15 Am. St. Rep. 893.
  - (10) *Theaters, trains, restaurants, etc.*: 1883, *Civil Rights Cases*, 109 U. S. 3; 1888, *People v. King*, 110 N. Y. 418, 6 Am. St. Rep. 389; 1890, *Ferguson v. Gies*, 82 Mich. 358, 21 Am. St. Rep. 576; 1890, *Louisville, N. O. & T. R. Co. v. Miss.*, 133 U. S. 587; 1896, *Plessy v. Ferguson*, 163 U. S. 537; 1900, *Chesapeake & O. R. Co. v. Kentucky*, 179 U. S. 388; compare, 1877, *Hall v. DeCuir*, 95 U. S. 485; 1892, *Younger v. Judah*, 111 Mo. 303, 33 Am. St. Rep. 527.
  - (11) *Warehouses* and *elevators*: 1876, *Munn v. Illinois*, 94 U. S. 113; 1882, *Nash v. Page*, 80 Ky. 539, 44 Am. Rep. 490; 1892, *Budd v. New York*, 143 U. S. 517; 1894, *Brass v. Stoesser*, 153 U. S. 391; 1896, *Stewart v. Great N. R.*, 65 Minn. 515. See note, 62 Am. St. Rep. 289.

(12) *Water companies*: 1884, *Spring Valley Water W. Co. v. Schottler*, 110 U. S. 347; 1887, *Wheeler v. Northern, etc., Co.*, 10 Colo. 582, 3 Am. St. Rep. 603; 1895, *American W. W. v. State*, 46 Neb. 194, 50 Am. St. Rep. 610; 1896, *White v. Canal Co.*, 22 Colo. 191; 1897, *San Diego W. Co. v. City of San Diego*, 118 Cal. 556, 62 Am. St. Rep. 261, note 289. See note *supra*, p. 1318, under *Mandamus*; 1904, *Newburyport Water Co. v. Newburyport*, 193 U. S. 561.

(13) *Wharves*, if they are held out to be for the public use: 1861, *Dutton v. Strong*, 1 Black (U. S.) 23; 1896, *Barrington v. Dock Co.*, 15 Wash. 170.

3. *As affected by the power of congress to regulate commerce*: Mr. Justice Brown in 1893, *Covington Bridge Co. v. Kentucky*, 154 U. S. 204, on 209 *et seq.*, says "the powers of the states over the general subject of commerce are divisible into three classes," viz.—citing most of the cases following):

(1.) *Exclusive in the states*,—including all those which "concern the strictly internal commerce of the state, and while the regulations of the state may affect interstate commerce indirectly, their bearing upon it is so remote that it can not be termed in any just sense an interference." Under this the states:

(a) "May authorize the construction of highways, turnpikes, railways and canals between points in the same state, and regulate the tolls for the use of the same," and the management of them: 1874, *Railroad v. Maryland*, 21 Wall. 456; 1897, *Gladson v. State of Minn.*, 166 U. S. 427;

(b) May "build bridges over non-navigable streams, or regulate the navigation of internal waters, if they do not themselves, or with others, form continuous highways of interstate commerce:" 1852, *Veazie v. Moor*, 14 How. 568; 1870, *The Montello*, 11 Wall. 411, s. c. 1874, 20 Wall. 430;

(c) May "regulate its strictly internal trade:" 1866, *License Tax Cases*, 5 Wall. 462, 470, 471; 1869, *U. S. v. Dewitt*, 9 Wall. 41; 1878, *Patterson v. Kentucky*, 97 U. S. 501;

(d) And may "prescribe the form of all commercial contracts:" 1879, *The Trade-Mark Cases*, 100 U. S. 82.

(2.) *Concurrent with those of congress*, at least till congress acts inconsistently with the state regulations. The powers here are:

(a) To regulate pilots: 1851, *Cooley v. Phil. Board of Wardens*, 12 How. 299; 1864, *Steamship Co. v. Joliffe*, 2 Wall. 450; 1871, *Ex parte McNiel*, 13 Wall. 236; 1880, *Wilson v. McNamee*, 102 U. S. 572.

(b) To enact quarantine and inspection laws, and provide for policing harbors: 1824, *Gibbons v. Ogden*, 9 Wheat. 1, 203; 1837, *City of New York v. Miln*, 11 Pet. 102; 1882, *Baker v. State*, 54 Wis. 368; 1882, *Turner v. Maryland*, 107 U. S. 38; 1886, *Morgan Steamship Co. v. Louisiana*, 118 U. S. 455; 1888, *Faircloth v. DeLeon*, 81 Ga. 158; 1890, *Stokes v. Dept. of Agriculture*, 106 N. C. 439; 1893, *Vanmeter v. Spurrier*, 94 Ky. 22; 1894, *Kirby v. Huntsville Fertilizer Co.*, 105 Ala. 529; 1898, *Patapsco Guano Co. v. North Carolina*, 171 U. S. 345. But such regulations must not be unreasonable, or be in fact regulations of interstate commerce: 1877, *Railroad Co. v. Husen*, 95 U. S. 465; 1886, *Walling v. Michigan*, 116 U. S. 446; 1890, *Minnesota v. Barber*, 136 U. S. 313; 1891, *Brimmer v. Rebman*, 138 U. S. 78; 1891, *Voight v. Wright*, 141 U. S. 62; 1897, *Scott v. Donald*, 165 U. S. 58.

(c) To improve navigable channels: 1880, *County of Mobile v. Kimball*, 102 U. S. 691; 1882, *Escanaba Co. v. Chicago*, 107 U. S. 678; 1886, *Huse v. Glover*, 119 U. S. 543.

(d) To regulate wharves, piers and docks: 1874, *Cannon v. New Orleans*, 20 Wall. 577; 1877, *Packet Co. v. Keokuk*, 95 U. S. 80; 1879, *Packet Co. v. St. Louis*, 100 U. S. 423; 1881, *Packet Co. v. Catlettsburg*, 105 U. S. 559; 1882, *Transportation Co. v. Parkersburg*, 107 U. S. 691; 1887, *Onachita Packet Co. v. Aiken*, 121 U. S. 444.

(e) To bridge or dam navigable waters of the state: 1829, *Wilson v. Black Bird Creek Marsh Co.*, 2 Pet. 245; 1877, *Pound v. Turck*, 95 U. S. 459; 1885, *Cardwell v. Am. Br. Co.*, 113 U. S. 205.

(f) To establish ferries: 1861, *Conway v. Taylor's Executor*, 1 Black 603.

(g) To forbid the running of through freight trains upon Sunday: 1896, *Hennington v. Georgia*, 163 U. S. 299.

(h) To require a reasonable number of trains to stop at places to accommodate the traffic: 1897, *Gladson v. Minnesota*, 166 U. S. 427; 1899, *Lake Shore & W. S. R. v. Ohio*, 173 U. S. 285, but not to go an unreasonable distance out of the main way for such purpose; 1896, *Illinois Central R. v. Illinois*, 163 U. S. 142.

(i) To forbid the heating of cars by stoves: 1897, *New York, etc., R. Co. v. New York*, 165 U. S. 628 (citing cases p. 631).

(j) To require the prompt delivery of telegrams: 1896, *West. U. Tel. Co. v. James*, 162 U. S. 650; compare, 1887, *Western U. Tel. Co. v. Pendleton*, 122 U. S. 347.

In this class of cases, while the powers of the states and the nation are concurrent so far as they are compatible, yet where they become incompatible the legislation of congress necessarily supersedes that of the states; it is not, however, "the mere *existence* of such a power, but its *exercise* by congress which may be incompatible with the exercise of the same power by the states, and the states may legislate in the absence of congressional legislation;" 1851, *Cooley v. Board of Wardens*, 12 How. 299, 318; 1855, *Pennsylvania v. Wheeling, etc., Co.*, 18 How. 421; 1882, *Escanaba Co. v. Chicago*, 107 U. S. 678; 1886, *Huse v. Glover*, 119 U. S. 543; 1896, *Hennington v. Georgia*, 163 U. S. 299; 1897, *Gladson v. State of Minnesota*, 166 U. S. 427; 1899, *L. S. & M. S. R. v. Ohio*, 173 U. S. 285.

"Under this power also the states may tax the *instruments* of interstate commerce as it taxes other similar property, provided such tax be not laid upon the commerce:" 1893, *Covington, etc., Bridge Co. v. Kentucky*, 154 U. S. 204, 212.

(3.) *Exclusive in congress*: Whenever the matters instead of being of a local nature, are national in their character, or admit of a uniform system or plan of regulation, "the non-action of congress indicates its will that such commerce shall be free and untrammelled,"—here "the states have no right to impose restrictions, either by way of taxation, discrimination, or regulation, upon commerce between the states:" 1824, *Gibbon v. Ogden*, 9 Wheat 1; 1885, *Brown v. Houston*, 114 U. S. 622; 1887, *Robbins v. Shelby Taxing District*, 120 U. S. 489; 1888, *Bowman v. Chicago, etc., R.*, 125 U. S. 465; 1890, *Leisy v. Hardin*, 135 U. S. 100; 1893, *Covington, etc., Bridge Co. v. Kentucky*, 154 U. S. 204; 1896, *Scott v. Donald*, 165 U. S. 58; 1898, *Schollenberger v. Pennsylvania*, 171 U. S. 1; 1900, *Austin v. Tennessee*, 179 U. S. 343.

## Sec. 438. (3) Taxation.

(a) Corporate elements subject to taxation.

### FARRINGTON v. TENNESSEE.<sup>1</sup>

1877. IN THE SUPREME COURT OF THE UNITED STATES. 95 U. S. Rep. 679-694.

[Error from supreme court of Tennessee. Farrington was the owner of 150 shares of \$100 each of the stock of the U. & P. Bank of Memphis, incorporated in 1858, by the legislature of Tennessee; the charter provided "that the said company shall pay to the state an annual tax of one-half of one per cent. on each share of the capital stock subscribed, which shall be in lieu of all other taxes." In 1872, the state taxed the shares of Farrington, under the state and county

<sup>1</sup> Statement abridged; part of opinion, and dissenting opinion of Story, J. (Clifford & Field, JJ., concurring), omitted.

revenue laws, to the amount of \$240 in addition to the tax paid by the bank. Farrington objected that the revenue laws were unconstitutional as impairing the obligation of the contract. The state supreme court adjudged the taxes valid; this is the error assigned].

MR. JUSTICE SWAYNE. \* \* \* This case turns upon the construction to be given to the tenth section of the charter of the bank. Our attention has been called to nothing else.

The exercise of the taxing power is vital to the functions of government. Except where specially restrained the states possess it to the fullest extent. *Prima facie* it extends to all property, corporeal and incorporeal, and to every business by which livelihood or profit is sought to be made within their jurisdiction. When exemption is claimed it must be shown indubitably to exist. At the outset every presumption is against it. A well-founded doubt is fatal to the claim. It is only when the terms of the concession are too explicit to admit fairly of any other construction that the proposition can be supported. *West Wisconsin Railway Co. v. Board of Supervisors*, 93 U. S. 595; *Tucker v. Ferguson*, 22 Wall. 527.

Can the exemption here in question, examined by the light of these rules, be held valid?

Upon looking into the section several things clearly appear:

1. The tax specified is upon each share of the capital stock, and not upon the capital stock itself. 2. It is upon each share subscribed. Nothing is said about what is paid in upon it. That is immaterial. The fact of subscription is the test, and that alone is sufficient. 3. This tax is declared to be "in lieu of all other taxes." Such was the contract of the parties.

The capital stock and the shares of the capital stock are distinct things. The capital stock is the money paid or authorized or required to be paid in as the basis of the business of the bank, and the means of conducting its operations. It represents whatever it may be invested in. If a large surplus be accumulated and laid by, that does not become a part of it. The amount authorized can not be increased without proper legal authority. If there be losses which impair it, there can be no formal reduction without the like sanction. No power to increase or diminish it belongs inherently to the corporation. It is a trust fund held by the corporation as a trustee. It is subject to taxation like other property. If the bank fail, equity may lay hold of it, administer it, pay the debts, and give the residuum, if there be any, to the stockholders. If the corporation be dissolved by judgment of law, equity may interpose and perform the same functions. *Wood v. Dummer*, 3 Mason 308; *Curran v. Arkansas*, 15 How. 304; *Gordon v. The Appeal Tax Court*, 3 How. 133; *People v. The Commissioners*, 4 Wall. 244; *Van Allen v. The Assessors*, 3 Wall. 573; *Queen v. Arnaud*, 9 Ad. & E. (N. S.) 806; *Bank Tax Cases*, 2 Wall. 200.

The shares of the capital stock are usually represented by certificates. Every holder is a *cestui que trust* to the extent of his ownership. The shares are held and may be bought and sold and taxed

like other property. Each share represents an aliquot part of the capital stock. But the holder can not touch a dollar of the principal. He is entitled only to share in the dividends and profits. Upon the dissolution of the institution, each shareholder is entitled to a proportionate share of the residuum after satisfying all liabilities. The liens of all creditors are prior to his. The corporation, though holding and owning the capital stock, can not vote upon it. It is the right and the duty of the shareholders to vote. They in this way give continuity to the life of the corporation, and may thus control and direct its management and operations. The capital stock and the shares may both be taxed, and it is not double taxation. The bank may be required to pay the tax out of its corporate funds, or be authorized to deduct the amount paid for each stockholder out of his dividends. *Angell & A. on Corp.*, sections 556, 557; *Union Bank v. The State*, 9 Yerg. (Tenn.) 489; *Van Allen v. The Assessors*, *supra*; *Bradley v. The People*, 4 Wall. 459; *Queen v. Arnaud*, *supra*; *National Bank v. Commonwealth*, 9 Wall. 353; *The State v. Branin*, 3 Zab. (N. J.) 484; *M'Culloch v. Maryland*, 4 Wheat. 316.

There are other objects in this connection liable to taxation. It may be well to advert to some of them.

1. The franchise to be a corporation and exercise its powers in the prosecution of its business. *Burroughs on Taxation*, § 85; *Hamilton v. Massachusetts*, 6 Wall. 632; *Wilmington Railroad v. Reid*, 13 Wall. 264.

2. Accumulated earnings. *The State v. Utter*, 34 N. J. L. 489; *The St. Louis Mutual Insurance Co. v. Charles*, 47 Mo. 462.

3. Profits and dividends. *The Attorney-General v. Bank, etc.*, 4 Jones (N. C.) Eq. 287.

4. Real estate belonging to the corporation and necessary for its business. *Wilmington Railroad v. Reid*, *supra*; *The Bank of Cape Fear v. Edwards*, 5 Ired. (N. C.) L. 516.

5. Banks and bankers are taxed by the United States:

1. On their deposits. 2. On the capital employed in their business. 3. On their circulation. 4. On the notes of every person or state bank used and paid out for circulation. *Rev. St. 673, et seq.*

The states are permitted, in addition, to tax the shares of the national banks. *Rev. St. 1015.*

This enumeration shows the searching and comprehensive taxation to which such institutions are subjected; where there is no protection by previous compact.

Unrestrained power to tax is power to destroy. *M'Culloch v. Maryland*, *supra*.

When this charter was granted the state might have been silent as to taxation. In that case, the power would have been unfettered. *The Providence Bank v. Billings*, 4 Pet. 514. It might have reserved the power as to some things, and yielded it as to others. It had the power to make its own terms, or to refuse the charter. It chose to stipulate for a specified tax on the shares, and declared and bound itself that this tax should be "in lieu of all other taxes."



There is no question before us as to the tax imposed on the shares by the charter. But the state has by her revenue law imposed another and an additional tax on these same shares. This is one of those "other taxes" which it had stipulated to forego. The identity of the thing doubly taxed is not affected by the fact that in one case the tax is to be paid vicariously by the bank, and in the other by the owner of the share himself. The thing thus taxed is still the same, and the second tax is expressly forbidden by the contract of the parties. After the most careful consideration, we can come to no other conclusion. Such, we think, must have been the understanding and intent of the parties when the charter was granted and the bank organized. Any other view would ignore the covenant that the tax specified should be "in lieu of all other taxes." It would blot those terms from the context, and construe it as if they were not a part of it. \* \* \*

*Reversed.*

*Note.* See, generally: 1836, *Union Bank v. State*, 9 Yerger (Tenn.) 490; 1865, *Van Allen v. Assessors*, 3 Wall. 573; 1875, *Louisville & N. R. Co. v. State*, 8 Heisk. (55 Tenn.) 663, 795; 1877, *Memphis v. Farrington*, 8 Baxter (Tenn.) 539; 1886, *Tennessee v. Whitworth*, 117 U. S. 129, 139; 1896, *Shelby Co. v. Union and Planters' Bank*, 161 U. S. 149, 3 Am. & E. C. C. (N. S.) 333; see other cases in 161 U. S. on pp. 134, 161, 174, 186, 193, 198 and 200; 1897, *New Orleans v. Citizens' Bank*, 167 U. S. 371, on 402; 1899, *Owensboro Nat. Bank v. City of Owensboro*, 173 U. S. 664. See also note *supra*, p. 781, *et seq.*

By the great weight of authority, the shares held by the shareholders are taxable to them, notwithstanding the property, capital, or capital stock, or franchise, has been taxed also. In some states, however, this is considered double taxation: 1866, *Dwight v. Mayor*, 12 Allen (Mass.) 316, 90 Am. Dec. 149; 1873, *City of Memphis v. Ensley*, 6 Baxter (Tenn.) 553, 32 Am. Rep. 532; 1876, *Dyer v. Osborne*, 11 R. I. 321, 23 Am. Rep. 460; 1880, *Worth v. Ashe Co.*, 82 N. C. 420, 33 Am. Rep. 692; 1880, *Bradley v. Bauder*, 36 O. S. 28, 38 Am. Rep. 547; 1888, *Street R. Co. v. Morrow*, 87 Tenn. 406, 2 L. R. A. 853; 1894, *Commonwealth v. Charlottesville, etc., Co.*, 90 Va. 790, 44 Am. St. Rep. 950, note; 1900, *Greenleaf v. Board of Review*, 184 Ill. 226, 75 Am. St. Rep. 168; 1900, *Jennings v. Commonwealth*, 98 Va. 87, 34 S. E. Rep. 981; 1900, *Atlanta Natl. B. & L. Ass'n v. Stewart*, 109 Ga. 80, 35 S. E. Rep. 73; see, *contra*, 1899, *In re Newport Reading Room*, 21 R. I. 440, 44 Atl. 511.

## Sec. 439. (b) Capital and capital stock.<sup>1</sup>

See *Commercial Fire Ins. Co. v. Board of Revenue*, 99 Ala. 1, *supra*, p. 773; *People, ex rel. U. T. Co. v. Coleman*, 126 N. Y. 433, *supra*, p. 778, note 781, *et seq.*

*Note.* Mr. Beach, *Private Corporations*, § 802, says: "There are eight methods of taxing capital stock of corporations, to wit: (1) A tax upon the capital stock when the company during any year makes dividends to six per cent. or more on the *par value of its capital* (*People v. Horn Silver M. Co.*, 105 N. Y. 76); (2) a tax upon the *whole capital stock at par* (N. J. Law, April 18, 1884); (3) upon the *capital stock at its actual cash or market value* (Ind. R. S. 1887, § 6357; Ill. R. S., ch. 120, § 3); (4) upon so much of the *capital stock* as has been *subscribed to and paid in* (Md. Laws 1878, ch. 178); (5) upon the *capital stock plus the bonded debt* of the company at market value (*Lehigh Valley*

<sup>1</sup> See note, 58 L. R. A. 513.



R. Co. v. Commonwealth, 129 Pa. St. 429); (6) upon the *capital stock plus the total debt*, both funded and floating (Conn. G. S., § 3919); (7) upon the *capital stock less property* otherwise taxed (N. Y. Laws 1837, ch. 456, § 3; Ala. Code, § 453, sub. 9); (8) upon the *capital stock less the indebtedness* of the corporation (People v. Coleman, 1 N. Y. Supp. 666.)”

See, also, 1891, Foster v. Stevens, 63 Vt. 145, 13 L. R. A. 166, and note; 1891, Hyland v. Central I. & S. Co., 129 Ind. 68, 13 L. R. A. 515, note.

Sec. 440. (c) Tangible property, and movable property.

PULLMAN'S PALACE CAR COMPANY v. PENNSYLVANIA.<sup>1</sup>

1891. IN THE SUPREME COURT OF THE UNITED STATES. 141 U. S. Rep. 18-36.

[Action by the state of Pennsylvania to collect taxes assessed in that state against the car company for the years 1870 to 1880; the taxes were assessed under successive laws—those for the years 1870-1874—at the rate of half a mill on every one per cent. of dividend upon the capital stock of every corporation doing business in Pennsylvania; those for 1875-1877 at the rate of nine-tenths of a mill on every one per cent. of dividend on the capital stock of “all corporations in any way engaged in the transportation of freight or passengers;” those for 1878-1880, at the rate of half a mill on each one per cent. of dividend of six per cent. or more on the par value of the capital stock, and when the dividend was less, at three mills on a valuation of the capital stock, on all corporations (with certain exceptions). The car company was organized in Illinois and had its principal office in Chicago. Its business was to furnish sleeping coaches to various railroad companies which attached them to their trains, no charge being made by either party against the other. The railroad companies collected the usual fares from passengers, and the car company a separate charge for seats, berths, etc. In this way between 1870 and 1880, the defendant had continuously in use on the Pennsylvania railroads running into, through and out of the state, about 100 of its cars and coaches. The lower court held “that the proportion of the capital stock of the defendant invested and used in Pennsylvania was taxable under these acts, and that the amount of the tax may be properly ascertained by taking as a basis the proportion which the number of miles operated by the defendant in this state bears to the whole number of miles, operated by it, without regard to the question where any particular car or cars were used,” and gave judgment for the state. This was affirmed by the supreme court of the state, and the car company sued out a writ of error because the state courts erred in holding that any part of its capital stock was subject to taxation in

<sup>1</sup> Statement abridged. Dissenting opinion of Mr. Justice Bradley (Mr. Justice Field and Mr. Justice Harlan concurring) omitted.

Pennsylvania, by reason of its running any of its cars into, out of, or through that state, in the interstate transportation of passengers.]

MR. JUSTICE GRAY: Upon this writ of error, whether this tax was in accordance with the law of Pennsylvania is a question on which the decision of the highest court of the state is conclusive. The only question of which this court has jurisdiction is whether the tax was in violation of the clause of the constitution of the United States granting to congress the power to regulate commerce among the several states. The plaintiff in error contends that its cars could be taxed only in the state of Illinois, in which it was incorporated and had its principal place of business.

No general principles of law are better settled, or more fundamental, than that the legislative power of every state extends to all property within its borders, and that only so far as the comity of that state allows can such property be affected by the law of any other state. The old rule, expressed in the maxim *mobilia sequuntur personam*, by which personal property was regarded as subject to the law of the owner's domicile, grew up in the Middle Ages, when movable property consisted chiefly of gold and jewels, which could be easily carried by the owner from place to place, or secreted in spots known only to himself. In modern times, since the great increase in amount and variety of personal property, not immediately connected with the person of the owner, that rule has yielded more and more to the *lex situs*, the law of the place where the property is kept and used. *Green v. Van Buskirk*, 5 Wall. 307, and 7 Wall. 139; *Hervey v. Rhode Island Locomotive Works*, 93 U. S. 664; *Harkness v. Russell*, 118 U. S. 663, 679; *Walworth v. Harris*, 129 U. S. 355; *Story on Conflict of Laws*, § 550; *Wharton on Conflict of Laws*, §§ 297-311. As observed by Mr. Justice Story, in his commentaries, just cited, "although movables are for many purposes to be deemed to have no situs, except that of the domicile of the owner, yet this being but a legal fiction, it yields, whenever it is necessary for the purpose of justice that the actual situs of the thing should be examined. A nation within whose territory any personal property is actually situate has an entire dominion over it while therein, in point of sovereignty and jurisdiction, as it has over immovable property situate there."

For the purposes of taxation, as has been repeatedly affirmed by this court, personal property may be separated from its owner and he may be taxed, on its account, at the place where it is, although not the place of his own domicile, and even if he is not a citizen or a resident of the state which imposes the tax. *Lane County v. Oregon*, 7 Wall. 71, 77; *Railroad Co. v. Pennsylvania*, 15 Wall. 300, 323, 324, 328; *Railroad Co. v. Peniston*, 18 Wall. 5, 29; *Tappan v. Merchants' Bank*, 19 Wall. 490, 499; *State Railroad Tax Cases*, 92 U. S. 575, 607, 608; *Brown v. Houston*, 114 U. S. 622; *Coe v. Errol*, 116 U. S. 517, 524; *Marye v. Baltimore & Ohio Railroad*, 127 U. S. 117, 123.

It is equally well settled that there is nothing in the constitution or laws of the United States which prevents a state from taxing personal

property, employed in interstate or foreign commerce, like other personal property within its jurisdiction. *Delaware Railroad Tax*, 18 Wall. 206, 232; *Telegraph Co. v. Texas*, 105 U. S. 460, 464; *Gloucester Ferry Co. v. Pennsylvania*, 114 U. S. 196, 206, 211; *Western Union Telegraph Co. v. Attorney-General of Massachusetts*, 125 U. S. 530, 549; *Marye v. Baltimore & Ohio Railroad*, 127 U. S. 117, 124; *Leloup v. Mobile*, 127 U. S. 640, 649.

Ships or vessels, indeed, engaged in interstate or foreign commerce upon the high seas, or other waters which are a common highway, and having their home port at which they are registered under the laws of the United States, at the domicile of their owners in one state, are not subject to taxation in another state at whose ports they incidentally and temporarily touch for the purpose of delivering or receiving passengers or freight. But that is because they are not, in any proper sense, abiding within its limits and have no continuous presence or actual situs within its jurisdiction and, therefore, can be taxed only at their legal situs, their home port and the domicile of their owners. *Hays v. Pacific Mail Steamship Co.*, 17 How. 596; *St. Louis v. Ferry Co.*, 11 Wall. 423; *Morgan v. Parham*, 16 Wall. 471; *Wiggins Ferry Co. v. East St. Louis*, 107 U. S. 365; *Gloucester Ferry Co. v. Pennsylvania*, 114 U. S. 196.

Between ships and vessels, having their situs fixed by act of congress, and their course over navigable waters, and touching land only incidentally and temporarily; and cars or vehicles of any kind, having no situs so fixed, and traversing the land only, the distinction is obvious. As has been said by this court: "Commerce on land between the different states is so strikingly dissimilar, in many respects, from commerce on water, that it is often difficult to regard them in the same aspect in reference to the respective constitutional powers and duties of the state and federal governments. No doubt commerce by water was principally in the minds of those who framed and adopted the constitution, although both its language and spirit embrace commerce by land as well. Maritime transportation requires no artificial roadway. Nature has prepared to hand that portion of the instrumentality employed. The navigable waters of the earth are recognized public highways of trade and intercourse. No franchise is needed to enable the navigator to use them. Again, the vehicles of commerce by water being instruments of intercommunication with other nations, the regulation of them is assumed by the national legislature. So that state interference with transportation by water, and especially by sea, is at once clearly marked and distinctly discernable. But it is different with transportation by land." *Railroad Co. v. Maryland*, 21 Wall. 456, 470.

In *Gloucester Ferry Co. v. Pennsylvania*, on which the plaintiff in error much relies, the New Jersey corporation taxed by the state of Pennsylvania, under one of the statutes now in question, had no property in Pennsylvania except a lease of a wharf at which its steamboats touched to land and receive passengers and freight carried across the Delaware river; and the difference in the facts of that case and of

this, and in the rules applicable, was clearly indicated in the opinion of the court as follows: "It is true that property of corporations engaged in foreign or interstate commerce, as well as the property of corporations engaged in other business, is subject to taxation, provided always it be within the jurisdiction of the state." 114 U. S. 206. "While it is conceded that the property in a state belonging to a foreign corporation engaged in foreign or interstate commerce may be taxed equally with like property of a domestic corporation engaged in that business, we are clear that a tax or other burden imposed on the property of either corporation because it is used to carry on that commerce, or upon the transportation of persons or property, or for the navigation of the public waters over which the transportation is made, is invalid and void, as an interference with, and an obstruction of, the power of congress in the regulation of such commerce." 114 U. S. 211.

Much reliance is also placed by the plaintiff in error upon the cases in which this court has decided that citizens or corporations of one state can not be taxed by another state for a license or privilege to carry on interstate or foreign commerce within its limits. But in each of those cases the tax was not upon the property employed in the business, but upon the right to carry on the business at all, and was therefore held to impose a direct burden upon the commerce itself. *Moran v. New Orleans*, 112 U. S. 69, 74; *Pickard v. Pullman's Southern Car Co.*, 117 U. S. 34, 43; *Robbins v. Shelby Taxing District*, 120 U. S. 489, 497; *Leloup v. Mobile*, 127 U. S. 640, 644. For the same reason, a tax upon the gross receipts derived from the transportation of passengers and goods between one state and other states or foreign nations has been held to be invalid. *Fargo v. Michigan*, 121 U. S. 230; *Philadelphia & Southern Steamship Co. v. Pennsylvania*, 122 U. S. 326.

The tax now in question is not a license tax or a privilege tax; it is not a tax on business or occupation; it is not a tax on, or because of, the transportation, or the right of transit, of persons or property through the state to other states or countries. The tax is imposed equally on corporations doing business within the state, whether domestic or foreign, and whether engaged in interstate commerce or not. The tax on the capital of the corporation, on account of its property within the state, is, in substance and effect, a tax on that property: *Gloucester Ferry Co. v. Pennsylvania*, 114 U. S. 196, 209; *Western Union Telegraph Co. v. Attorney-General of Massachusetts*, 125 U. S. 530, 552. This is not only admitted, but insisted on, by the plaintiff in error.

The cars of this company within the state of Pennsylvania are employed in interstate commerce, but their being so employed does not exempt them from taxation by the state, and the state has not taxed them because of their being so employed, but because of their being within its territory and jurisdiction. The cars were continuously and permanently employed in going to and fro upon certain routes of travel. If they had never passed beyond the limits of Pennsylvania it

could not be doubted that the state could tax them, like other property within its borders, notwithstanding they were employed in interstate commerce. The fact that, instead of stopping at the state boundary, they cross that boundary in going out and coming back can not affect the power of the state to levy a tax upon them. The state having the right, for the purposes of taxation, to tax any personal property found within its jurisdiction, without regard to the place of the owner's domicile, could tax the specific cars which at a given moment were within its borders. The route over which the cars travel extending beyond the limits of the state, particular cars may not remain within the state, but the company has at all times substantially the same number of cars within the state, and continuously and constantly uses there a portion of its property; and it is distinctly found, as matter of fact, that the company continuously, throughout the periods for which these taxes were levied, carried on business in Pennsylvania and had about one hundred cars within the state.

The mode which the state of Pennsylvania adopted to ascertain the proportion of the company's property upon which it should be taxed in that state, was by taking as a basis of assessment such proportion of the capital stock of the company as the number of miles over which it ran cars within the state bore to the whole number of miles in that and other states over which its cars were run. This was a just and equitable method of assessment, and if it were adopted by all the states through which these cars ran, the company would be assessed upon the whole value of its capital stock, and no more.

The validity of this mode of apportioning such a tax is sustained by several decisions of this court, in cases which came up from the circuit courts of the United States, and in which, therefore, the jurisdiction of this court extended to the determination of the whole case, and was not limited, as upon writs of error to the state courts, to questions under the constitution and laws of the United States.

In the State Railroad Tax Cases, 92 U. S. 575, it was adjudged that a statute of Illinois, by which a tax on the entire taxable property of a railroad corporation, including its rolling stock, capital and franchise, was assessed by the state board of equalization, and was collected in each municipality in proportion to the length of the road within it, was lawful, and not in conflict with the constitution of the state; and Mr. Justice Miller delivering judgment said:

"Another objection to the system of taxation by the state is, that the rolling stock, capital stock and franchise are personal property, and that this, with all other personal property, has a local situs at the principal place of business of the corporation, and can be taxed by no other county, city or town but the one where it is so situated. This objection is based upon the general rule of law that personal property, as to its situs, follows the domicile of its owner. It may be doubted very reasonably whether such a rule can be applied to a railroad corporation as between the different localities embraced by its line of road. But, after all, the rule is merely the law of the state which recognizes it; and when it is called into operation as to property



located in one state, and owned by a resident of another, it is a rule of comity in the former state rather than an absolute principle in all cases. *Green v. Van Buskirk*, 5 Wall. 312. Like all other laws of a state, it is, therefore, subject to legislative repeal, modification or limitation; and when the legislature of Illinois declared that it should not prevail in assessing personal property of railroad companies for taxation, it simply exercised an ordinary function of legislation." 92 U. S. 607, 608.

"It is further objected that the railroad track, capital stock and franchise is not assessed in each county where it lies, according to its value there, but according to an aggregate value of the whole, on which each county, city and town collects taxes according to the length of the track within its limits." "It may well be doubted whether any better mode of determining the value of that portion of the track within any one county has been devised than to ascertain the value of the whole road, and apportion the value within the county by its relative length to the whole." "This court has expressly held in two cases, where the road of a corporation ran through different states, that a tax upon the income or franchise of the road was properly apportioned by taking the whole income or value of the franchise, and the length of the road within each state, as the basis of taxation. *Delaware Railroad Tax*, 18 Wall. 206; *Erie Railroad Co. v. Pennsylvania*, 21 Wall. 492." 92 U. S. 608, 611.

So in *Western Union Telegraph Co. v. Attorney-General of Massachusetts*, 125 U. S. 530, this court upheld the validity of a tax imposed by the state of Massachusetts upon the capital stock of a telegraph company, on account of property owned and used by it within the state, taking as the basis of assessment such proportion of the value of its capital stock as the length of its lines within the state bore to their entire length throughout the country.

Even more in point is the case of *Marye v. Baltimore & Ohio Railroad*, 127 U. S. 117, in which the question was whether a railroad company incorporated by the state of Maryland, and no part of whose own railroad was within the state of Virginia, was taxable under general laws of Virginia upon rolling stock owned by the company, and employed upon connecting railroads leased by it in that state, yet not assigned permanently to those roads, but used interchangeably upon them and upon roads in other states, as the company's necessities required. It was held not to be so taxable; solely because the tax laws of Virginia appeared upon their face to be limited to railroad corporations of that state; and Mr. Justice Matthews, delivering the unanimous judgment of the court, said:

"It is not denied, as it can not be, that the state of Virginia has rightful power to levy and collect a tax upon such property used and found within its territorial limits, as this property was used and found, if and whenever it may choose, by apt legislation, to exert its authority over the subject. It is quite true, as the situs of the Baltimore and Ohio Railroad Company is in the state of Maryland, that, also, upon general principles, is the situs of all its personal property;



but for purposes of taxation, as well as for other purposes, that situs may be fixed in whatever locality the property may be brought and used by its owner by the law of the place where it is found. If the Baltimore and Ohio Railroad Company is permitted by the state of Virginia to bring into its territory, and there habitually to use and employ a portion of its movable personal property, and the railroad company chooses so to do, it would certainly be competent and legitimate for the state to impose upon such property, thus used and employed, its fair share of the burdens of taxation imposed upon similar property used in the like way by its own citizens. And such a tax might be properly assessed and collected in cases like the present, where the specific and individual items of property so used and employed were not continuously the same, but were constantly changing, according to the exigencies of the business. In such cases the tax might be fixed by an appraisal and valuation of the average amount of the property thus habitually used, and collected by distraint upon any portion that might at any time be found. Of course, the lawlessness of a tax upon vehicles of transportation used by common carriers might have to be considered in particular instances with reference to its operation as a regulation of commerce among the states, but the mere fact that they were employed as vehicles of transportation in the interchange of interstate commerce would not render their taxation invalid." 127 U. S. 123, 124.

For these reasons, and upon these authorities, the court is of opinion that the tax in question is constitutional and valid. The result of holding otherwise would be that, if all the states should concur in abandoning the legal fiction that personal property has its situs at the owner's domicile, and in adopting the system of taxing it at the place at which it is used and by whose laws it is protected, property employed in any business requiring continuous and constant movement from one state to another would escape taxation altogether.

*Judgment affirmed.*

*Note:* Taxation of railroads, rolling stock, vessels, and migratory property: See generally, notes 56 Am. Dec. 525, 535; 79 Am. Dec. 333; 62 Am. St. Rep. 459, 470, 476.

*Railroads:* 1852, Sangamon, etc., R. Co. v. Morgan Co., 14 Ill. 163, 56 Am. Dec. 497, note 525; 1865, Louisville, etc., R. Co. v. State, 25 Ind. 177, 87 Am. Dec. 358; 1868, Applegate v. Ernst, 3 Bush (Ky.) 648, 96 Am. Dec. 272; 1870, Pittsburgh, etc., R. Co. v. Commonwealth, 66 Pa. St. 73, 5 Am. Rep. 344; 1873, Delaware R. Tax, 18 Wall. 206; 1874, Railroad Co. v. Maryland, 21 Wall. (U. S.) 456; 1894, Pittsburgh, etc., R. Co. v. Backus, 154 U. S. 421; 1895, New York, etc., R. Co. v. Pennsylvania, 158 U. S. 431; 1899, Territory of New Mexico v. U. S. Trust Co., 174 U. S. 545; 1899, Ames v. People, 26 Colo. 83, 56 Pac. Rep. 656.

*Rolling stock:* 1852, Sangamon, etc., R. Co. v. Morgan Co., 14 Ill. 163, 56 Am. Dec. 497, note 525; 1873, Randall v. Elwell, 52 N. Y. 521, 11 Am. Rep. 747; 1876, Elizabethtown, etc., R. v. Elizabethtown, 12 Bush (Ky.) 233; 1884, Pickard v. Pullman, etc., Car Co., 117 U. S. 34; see also, p. 51; 1885, Carlisle v. Pullman Pal. Car Co., 8 Colo. 320, 54 Am. Rep. 553; 1888, Atlantic & Pac. R. Co. v. Lesueur (Ariz.), 1 L. R. A. 244; 1890, Bain v. Richmond, etc., R. Co., 105 N. C. 363, 18 Am. St. Rep. 912, 8 L. R. A. 299, note; 1891, Denver, etc., R. Co. v. Church, 17 Colo. 1, 31 Am. St. Rep. 252; 1897, Hall v. American Refrigerator Co., 24 Colo. 291, 65 Am. St. Rep. 223; 1898, State v. Stephens, 146

Mo. 662, 69 Am. St. Rep. 625; 1900, Union Refrig. Transit Co. v. Lynch, 177 U. S. 149; 1901, Pullman v. Adams, 78 Miss. 814, 84 Am. St. Rep. 647, 30 So. 757; 1903, Pullman Co. v. Adams, 189 U. S. 420; 1903, Allen v. Pullman Co., 191 U. S. 171.

*Vessels:* 1846, *Battle v. Mobile*, 9 Ala. 234, 44 Am. Dec. 438; 1878, *Transportation Co. v. Wheeling*, 99 U. S. 273; 1879, *Irvin v. N. O. R. Co.*, 94 Ill. 105, 34 Am. Rep. 208; 1883, *San Francisco v. Central Pac. R. Co.*, 63 Cal. 467, 49 Am. Rep. 98; 1896, *Johnson v. De Bary-Baya M. L.*, 37 Fla. 499, 37 L. R. A. 518, note; 1899, *Norfolk & W. R. v. Board of Public Works*, 97 Va. 23, 32 S. E. Rep. 779.

*Migratory property, in course of transportation:* See, 1890, *Bain v. Richmond*, etc., R. Co., 105 N. C. 363, 18 Am. St. Rep. 912; 1896, *Myers v. County Comm'rs*, 83 Md. 385, 55 Am. St. Rep. 349; 1898, *State v. Stephens*, 146 Mo. 662, 69 Am. St. Rep. 625; 1898, *Kelley v. Rhoads*, 7 Wyo. 237, 75 Am. St. Rep. 904; affirmed, 188 U. S. 1.

## Sec. 441. (d) Intangible property.

### ADAMS EXPRESS COMPANY v. OHIO STATE AUDITOR.<sup>1</sup>

1897. IN THE SUPREME COURT OF THE UNITED STATES. 165 U. S. Rep. 194-256.

The statute of the state of Ohio of April 27, 1893, 90 Laws Ohio 330 (amended May 10, 1894, 91 Laws Ohio 220), created a board of appraisers and assessors and required each telegraph, telephone and express company doing business within the state to make returns of the number of shares of its capital, the par value and market value thereof, its entire real and personal property, and where located and the value thereof as assessed for taxation, its gross receipts for the year of business wherever done, and of the business done in the state of Ohio, giving the receipts of each office in the state, and the whole length of the line of rail and water routes over which it did business within and without the state. It required the board of assessors to "proceed to ascertain and assess the value of the property of said express, telegraph and telephone companies in Ohio, and in determining the value of the property of said companies in this state, to be taxed within the state and assessed as herein provided, said board shall be guided by the value of said property as determined by the value of the entire capital stock of said companies, and such other evidence and rules as will enable said board to arrive at the true value in money of the entire property of said companies within the state of Ohio, in the proportion which the same bears to the entire property of said companies, as determined by the value of the capital stock thereof, and the other evidence and rules as aforesaid."

MR. CHIEF JUSTICE FULLER. \* \* \* The legislation in question is claimed to be repugnant to the constitution of the United States because in violation of the commerce clause of that instrument,

<sup>1</sup> Statement as given in the syllabus; arguments, part of opinion, and all of the dissenting opinion of White, J. (Field, Harlan and Brown, JJ., concurring), omitted. Upon a rehearing, 166 U. S. 185, this decision was affirmed, Mr. Justice Brewer delivering the opinion of the court. This should be read.

and because operating to deprive appellants of their property without due process of law, and of the equal protection of the laws.

We assume that the assessments complained of were made in pursuance of the definite rule or principle of appraisement recognized and established by the Nichols law, as construed by the supreme court of Ohio, and the question is whether the law prescribing that rule is valid under the federal constitution.

The principal contention is that the rule contravenes the commerce clause because the assessments, while purporting to be on the property of complainants within the state, are in fact levied on their business, which is largely interstate commerce.

Although the transportation of the subjects of interstate commerce, or the receipts received therefrom, or the occupation or business of carrying it on, can not be directly subjected to state taxation, yet property belonging to corporations or companies engaged in such commerce may be; and whatever the particular form of the exaction, if it is essentially only property taxation, it will not be considered as falling within the inhibition of the constitution. Corporations and companies engaged in interstate commerce should bear their proper proportion of the burdens of the governments under whose protection they conduct their operations, and taxation on property, collectible by the ordinary means, does not affect interstate commerce otherwise than incidentally, as all business is affected by the necessity of contributing to the support of government. *Postal Telegraph Cable Co. v. Adams*, 155 U. S. 688.

As to railroad, telegraph and sleeping-car companies, engaged in interstate commerce, it has often been held by this court that their property, in the several states through which their lines or business extended, might be valued as a unit for the purposes of taxation, taking into consideration the uses to which it was put and all the elements making up aggregate value, and that a proportion of the whole fairly and properly ascertained might be taxed by the particular state without violating any federal restriction. *Western Union Telegraph Co. v. Massachusetts*, 125 U. S. 530; *Massachusetts v. Western Union Telegraph Co.*, 141 U. S. 40; *Maine v. Grand Trunk Railway*, 142 U. S. 217; *Pittsburgh, Cincinnati, etc., Railway v. Backus*, 154 U. S. 421; *Cleveland, Cincinnati, etc., Railway v. Backus*, 154 U. S. 439; *Western Union Telegraph Co. v. Taggart*, 163 U. S. 1; *Pullman's Palace Car Co. v. Pennsylvania*, 141 U. S. 18. The valuation was, thus, not confined to the wires, poles and instruments of the telegraph company; or the roadbed, ties, rails and spikes of the railroad company; or the cars of the sleeping-car company; but included the proportionate part of the value resulting from the combination of the means by which the business was carried on, a value existing to an appreciable extent throughout the entire domain of operation. And it has been decided that a proper mode of ascertaining the assessable value of so much of the whole property as is situated in a particular state, is, in the case of railroads, to take that part of the value of the entire road which is measured by the propor-

tion of its length therein to the length of the whole. *Pittsburgh, etc., Railway v. Backus*, 154 U. S. 421; or taking as the basis of assessment such proportion of the capital stock of a sleeping-car company as the number of miles of railroad over which its cars are run in a particular state bears to the whole number of miles traversed by them in that and other states. *Pullman's Palace Car Co. v. Pennsylvania*, 141 U. S. 18; or such proportion of the whole value of the capital stock of a telegraph company as the length of its lines within a state bears to the length of all its lines everywhere, deducting a sum equal to the value of its real estate and machinery subject to local taxation within the state. *Western Union Tel. Co. v. Taggart*, 163 U. S. 1.

Doubtless there is a distinction between the property of railroad and telegraph companies and that of express companies. The physical unity existing in the former is lacking in the latter; but there is the same unity in the use of the entire property for the specific purpose, and there are the same elements of value arising from such use.

The cars of the Pullman Company did not constitute a physical unity, and their value as separate cars did not bear a direct relation to the valuation which was sustained in that case. The cars were moved by railway carriers under contract, and the taxation of the corporation in Pennsylvania was sustained on the theory that the whole property of the company might be regarded as a unit plant, with a unit value, a proportionate part of which value might be reached by the state authorities on the basis indicated.

No more reason is perceived for limiting the valuation of the property of express companies to horses, wagons and furniture than that of railroad, telegraph and sleeping-car companies, to roadbed, rails and ties; poles and wires; or cars. The unit is a unit of use and management, and the horses, wagons, safes, pouches and furniture; the contracts for transportation facilities; the capital necessary to carry on business, whether represented in tangible or intangible property, in Ohio, possessed a value in combination and from use in connection with the property and capital elsewhere, which could as rightfully be recognized in the assessment for taxation in the instance of these companies as the others.

We repeat that while the unity which exists may not be a physical unity, it is something more than a mere unity of ownership. It is a unity of use, not simply for the convenience or pecuniary profit of the owner, but existing in the very necessities of the case—resulting from the very nature of the business. \* \* \*

It is this which enables the companies represented here to charge and receive within the state of Ohio for the year ending May 1, 1895, \$282,181, \$358,519 and \$275,446, respectively, on the basis, according to their respective returns, of \$42,065, \$28,438 and \$23,430, of personal property owned in that state, returns which confessedly do not, however, take into account contracts for transportation and accompanying facilities.

Considered as distinct subjects of taxation, a horse is, indeed, a

horse; a wagon, a wagon; a safe, a safe; a pouch, a pouch; but how is it that \$23,430 worth of horses, wagons, safes and pouches produces \$275,446 in a single year? Or \$28,438 worth, \$358,519? The answer is obvious. \* \* \*

Assuming the proportion of capital employed in each of several states through which such a company conducts its operations has been fairly ascertained, while taxation thereon, or determined with reference thereto, may be said in some sense to fall on the business of the company, it is only indirectly. The taxation is essentially a property tax, and, as such, not an interference with interstate commerce.

Nor, in this view, is the assessment on property not within the jurisdiction of the taxing authorities of the state, and for that reason amounting to a taking of property without due process of law. The property taxed has its actual situs in the state and is, therefore, subject to the jurisdiction, and the distribution among the several countries is a matter of regulation by the state legislature. *Pullman's Palace Car Co. v. Pennsylvania*, 141 U. S. 18, 22; *State Railroad Tax Cases*, 92 U. S. 575; *Delaware Railroad Tax*, 18 Wall. 206; *Erie Railway v. Pennsylvania*, 21 Wall. 492; *Columbus Southern Railway v. Wright*, 151 U. S. 470.

In *Pullman's Palace Car Co. v. Pennsylvania*, the rule is considered that personal property may be separated from its owner and he may be taxed on its account at the place where it is, although not the place of his own domicile, and even if he is not a citizen or a resident of the state which imposes the tax, and the distinction between ships and vessels and other personal property is pointed out. The authorities are largely examined and need not be gone over again.

There is here no attempt to tax property having a situs outside of the state, but only to place a just value on that within. Presumptively all the property of the corporation or company is held and used for the purposes of its business, and the value of its capital stock and bonds is the value of only that property so held and used. \* \* \*

The states through which the companies operate ought not to be compelled to content themselves with a valuation of separate pieces of property disconnected from the plant as an entirety, to the proportionate part of which they extend protection, and to the dividends of whose owners their citizens contribute. \* \* \*

We are, also, unable to conclude that the classification of express companies with railroad and telegraph companies as subject to the unit rule, denies the equal protection of the laws. That provision in the fourteenth amendment "was not intended to prevent a state from adjusting its system of taxation in all proper and reasonable ways," nor was that amendment "intended to compel a state to adopt an iron rule of equal taxation." *Bell's Gap Railroad v. Pennsylvania*, 134 U. S. 232.

In *Pacific Express Co. v. Seibert*, 142 U. S. 339, 351, in which a tax on gross receipts of express companies in the state of Missouri was sustained, Mr. Justice Lamar, speaking for the court, well says:

"This court has repeatedly laid down the doctrine that diversity of



taxation, both with respect to the amount imposed and the various species of property selected either for bearing its burdens or for being exempt from them, is not inconsistent with a perfect uniformity and equality of taxation in the proper sense of those terms; and that a system which imposes the same tax upon every species of property, irrespective of its nature or condition or class, will be destructive of the principle of uniformity and equality in taxation and of a just adaptation of property to its burdens."

And see *Kentucky Railroad Tax Cases*, 115 U. S. 321; *Home Insurance Co. v. New York*, 134 U. S. 594. \* \* \*

Considering, as we do, that the unit rule may be applied to express companies without disregarding any other federal restriction, we think it necessarily follows that this law is not open to the objection of denying the equal protection of the laws. \* \* \*

*Decrees affirmed.*

*Note. Accord:* 1897, *Henderson Bridge Co. v. Kentucky*, 166 U. S. 150; 1897, *Adams Express Co. v. Kentucky*, 166 U. S. 171; 1897, *Adams Express Co. v. Ohio State Auditor*, 166 U. S. 185, 6 Am. & Eng. C. C. (N. S.) 404. See, also, following cases on patents, good-will, franchises, etc., with notes; 60 L. R. A. 641; 1903, *Western U. Tel. Co. v. Gottlieb*, 190 U. S. 412; 1904, *Fargo v. Hart*, 193 U. S. 490.

## Sec. 442. (e) Patents, copyrights, and good-will.

PEOPLE, *EX REL.*, THE A. J. JOHNSON COMPANY, APPELLANT, v. JAMES A. ROBERTS, COMPTROLLER, RESPONDENT.<sup>1</sup>

1899. IN THE COURT OF APPEALS OF NEW YORK. 159 N. Y. Rep., 70-86, 45 L. R. A. 126.

[Appeal from an order of appellate division affirming the comptroller's assessment of a tax upon relator's privilege of doing business in the state. The relator was incorporated in West Virginia, to publish and sell Johnson's Universal Encyclopedia, under copyrights assigned to it. It had no office in West Virginia, and substantially all of its business was conducted from its New York office. Its authorized capital stock was \$250,000—\$135,500 of preferred and \$88,000 common, \$70,000 worth of which had been issued. The comptroller based his tax upon \$148,600, as the capital stock employed in the state, including in his estimate the "books, copyrights, and good-will of the corporation," as having their situs within the state and subject to taxation under section 182 of the tax law. The relator objected that neither the copyrights nor good-will were subject to taxation within the state.]

VANN, J. Copyrights clearly stand on the same basis as patent rights, with reference to the subject of taxation by the state, and as we have held that the former are exempt the latter should be held exempt also. (*People, ex rel.*, *Edison Electric Il. Co. v. Board of Assessors*, 156

<sup>1</sup> Statement abridged, much of opinion of Vann, J., and all of dissenting opinion of Gray, J. (O'Brien & Haight, JJ., concurring), omitted.



N. Y. 417.) The comptroller, therefore, erred when he included the copyrights of the relator "among the items of property which went to make up" the amount "of the capital employed by it within this state." (L. 1896, ch. 908, section 182; L. 1880, ch. 542, section 3.)

No other item is open to discussion except the "good-will of the corporation and the good-will acquired by it," neither of which, as the appellant claims, was properly included as an element of value, because each is an intangible asset and beyond legislative control in this state.

In the Wiebusch Case (154 N. Y. 101) it was held that "the actual value of the capital stock of" a domestic corporation "is the value of its assets, after deducting its liabilities and adding to the sum then remaining the value of the good-will of the business, including its right to conduct it under its franchise." By this decision it is established that the good-will of a domestic corporation is property which was taxable as a part of its capital stock under the act of 1880. That act was repealed by chapter 908 of the laws of 1896, known as the tax law, which took effect June 15, 1896. The substance of the earlier act was re-enacted in the later with a decided change of arrangement and phraseology but, perhaps, with no change of meaning so far, at least, as the question now before us is concerned. By section 182 of the tax law it is provided that "every corporation \* \* \* formed under, by or pursuant to law in this state, shall pay to the state treasurer annually an annual tax to be computed upon the basis of the amount of its capital stock employed within this state and upon each dollar of such amount. \* \* \* Every corporation \* \* \* formed under the laws of any other state or country shall pay a like tax for the privilege of exercising its corporate franchises or carrying on its business in such corporate or organized capacity in this state, to be computed upon the basis of the capital employed by it within this state."

The remaining question presented for decision, therefore, is whether the good-will of the relator was "capital employed by it within this state."

Good-will is a modern but important growth of the law, not mentioned by some of the early writers, but given great prominence at the present time. In 1810 Lord Eldon defined it as "the probability that the old customers will resort to the old place." (Cruttwell v. Lye, 17 Ves. Jr. 335, 346.) \* \* \*

[Quoting from several cases and text-books as to the meaning of good-will.]

Good-will embraces at least two elements, the advantage of continuing an established business in its old place, and of continuing it under the old style or name. While it is not necessarily altogether local, it is usually to a great extent, and must, of necessity, be an incident to a place, an established business or a name known to the trade. \* \* \*

A tax of the kind under consideration is levied upon a foreign corporation "for the privilege of exercising its corporate franchises or

carrying on its business" in this state. (Tax law, § 182.) The good-will of the relator, aside from that purchased of Mr. Johnson, is the result of exercising its corporate franchises and carrying on its business in this state, and is inseparable from that business. It is the product of an investment of capital in this state, and the exercise here of the privilege for which the tax was laid. To hold that it was not capital employed in this state, upon the ground that the domicile of the corporation is in West Virginia, where it never transacted any business nor earned any good-will by fair dealing and efficient methods, would exalt form above substance. As the good-will is the result of the employment of capital and an incident to an established business, it can exist for no practical purpose in the state where the relator was organized and where it never invested any capital nor did any business. The good-will of the relator belongs to its old and well-established business, which is conducted wholly in this state. It is as much a part of its business as the books which it publishes. The good name of those books is a portion of it, acquired partly by purchase from the originator of the cyclopedia, who resided in this state. The value of that name has been increased by the enterprise of the relator in expending in this state over \$200,000 to enlarge and perfect the work. The value of the books and the other tangible property used in their production, is augmented by the good-will. The mere fact that good-will is intangible does not take it out of the state, so far as the right of taxation is concerned, because it is inseparably attached to property which is tangible, located in this state. (Matter of Houdayer, 150 N. Y. 37.) It exists at the place where it has a market value, which is where the relator carried on its business and earned a reputation for superior work and honorable conduct. This reputation was not built up in West Virginia, where it did no business, but in New York, where it did all its business. It could neither be sold nor used to advantage in the former state. \* \* \*

*Reversed for error as to copyright.*

*Note. Taxation of patents, copyrights, etc.* The right to the invention or stock invested in the patents, etc., themselves, or in licenses to sell the same, is not taxable by the states; but stock invested in patented articles, or the articles themselves, may be taxed by the state: 1831, *Jordan v. Overseers of Dayton*, 4 Ohio 295; 1878, *Patterson v. Kentucky*, 97 U. S. 501; 1879, *State v. Butler*, 3 Lea (Tenn.) 222; 1880, *Webber v. Virginia*, 103 U. S. 344; 1880, *State v. Telephone Co.*, 36 Ohio St. 296, 38 Am. Rep. 583; 1891, *Commonwealth v. Brush Co.*, 145 Pa. St. 147; 1891, *Commonwealth v. Cent. Dist. & P. T. Co.*, 145 Pa. St. 121, 27 Am. St. Rep. 677; 1891, *Commonwealth v. Edison El. L. Co.*, 145 Pa. St. 131, 27 Am. St. Rep. 683; 1892, *Commonwealth v. Westinghouse El. & Mfg. Co.*, 151 Pa. St. 265; 1893, *People, ex rel., Edison, etc., Co. v. Barker*, 139 N. Y. 55; 1893, *Commonwealth v. Edison El. L. Co.*, 157 Pa. St. 529, 37 Am. St. Rep. 747, note; 1893, *People v. Campbell*, 138 N. Y. 543; 1895, *Commonwealth v. Petty*, 96 Ky. 452, 29 L. R. A. 786, note; 1898, *People, ex rel., Edison El., etc., Co. v. Board, etc.*, 156 N. Y. 417, 42 L. R. A. 290; 1898, *Marsden Co. v. Board of Assessors*, 61 N. J. L. 461; 1898, *People, ex rel., Tel. Co. v. Neff*, 156 N. Y. 701; 1898, *Crown Cork & Seal Co. v. State*, 87 Md. 687, 67 Am. St. Rep. 371; 1899, *State v. Halliday*, 60 O. S. 592, 56 N. E. 118; 1899, *In re Jones*, 28 Misc. (N. Y.) 356 (good-will); 1903, *People v. Knight*, 174 N. Y. 475, 63 L. R. A. 87.

### Sec. 443. (f) Special franchises.

**SPRING VALLEY WATER WORKS CO. v. SCHOTTLER, 62 Cal. 69, supra, p. 120.**

*Note.* Taxation of corporate franchises: See note, 57 L. R. A. 33.

(1) *The primary franchise:* 1848, Mayor and City of Balt. v. B. & O. R. Co., 6 Gill (Md.) 288, 48 Am. Dec. 531; 1868, Manufacturers' Ins. Co. v. Loud, 99 Mass. 146, 96 Am. Dec. 715, note 716; 1882, Spring Valley W. W. Co. v. Schottler, 62 Cal. 69, *supra*, p. 120; 1888, Atlantic & Pac. R. Co. v. Lesueur (Ariz.), 1 L. R. A. 244, note; 1889, Home Ins. Co. v. New York, 134 U. S. 594; 1892, Horn Silver Min. Co. v. New York, 143 U. S. 305; 1895, People v. Metropolitan R., 146 N. Y. 304; 1897, People v. Barker, 152 N. Y. 417; 1897, D. L. & W. R. Co. v. Clapp, 152 N. Y. 490; 1898, Marsden v. Board, etc., 61 N. J. L. 461; 1898, People v. Roberts, 171 U. S. 658 (dissenting opinion reviews case); 1899, New York v. Roberts, 158 N. Y. 709; 1899, Owensboro Nat'l Bank v. City of Owensboro, 173 U. S. 664; 1899, Louisville Tobacco W. Co. v. Commonwealth, 20 Ky. L. Rep. 1747, 48 S. W. Rep. 1069; 1899, Latonia Agricultural, etc., Assn. v. Donnelly, 20 Ky. L. Rep. 1891, 50 S. W. Rep. 251; 1900, Board of Councilmen v. Stone, — Ky. —, 56 S. W. Rep. 679; 1900, Providence Banking Co. v. Webster Co., — Ky. —, 57 S. W. Rep. 14; see, also, cases *infra*, section 446; 1903, People v. Knight, 174 N. Y. 475, 63 L. R. A. 87.

State can not tax the primary federal franchise: 1888, California v. Cent. Pac. R. Co., 127 U. S. 1; but may tax state franchises held by federal corporations: 1896, Central Pac. R. Co. v. California, 162 U. S. 91; 1896, Southern Pac. R. Co. v. California, 162 U. S. 167.

(2) *Special or secondary franchises:* 1892, Yellow Riv. Imp. Co. v. Wood Co., 81 Wis. 554, 17 L. R. A. 92, note; 1897, Crescent City R. Co. v. Assessors, 51 La. Ann. 335, 25 So. Rep. 311; 1899, Owensboro Nat'l Bank v. City of Owensboro, 173 U. S. 664; 1899, State v. Duluth Gas W. Co., 76 Minn. 96, 78 N. W. Rep. 1032; 1899, Commercial El. L. Co. v. Judson, 21 Wash. 49, 56 Pac. Rep. 829; 1899, Paducah St. R. Co. v. McCracken Co., 20 Ky. L. Rep. 1294, 9 A. & E. Corp. Cas. N. S. 705, note 710; 1899, Ghee v. Northern U. Gas Co., 158 N. Y. 510; 1900, Edison Elec. Il. Co. v. Spokane Co., 22 Wash. 168, 60 Pac. Rep. 132; see article by J. N. Fiero, Esq., in 60 Alb. L. J. 277.

(3) *Property connected with the use of special franchises, such as water and gas pipes, etc., rights of way, etc.:* 1851, Providence Gas Co. v. Thurber, 2 R. I. 15, 55 Am. Dec. 621; 1869, Memphis G. L. Co. v. State, 6 Cold. (Tenn.) 310, 98 Am. Dec. 452; 1876, W. U. Tel. Co. v. State, 9 Baxt. (Tenn.) 509, 40 Am. Rep. 99; 1880, People v. Commissioners, 82 N. Y. 459; 1892, Yellow Riv. Imp. Co. v. Wood, 81 Wis. 554, 17 L. R. A. 92, note; 1893, Paris v. way Water Co., 85 Me. 330, 35 Am. St. Rep. 371; 1898, City of Grand Haven v. Grand Haven W. W., 119 Mich. 652, 78 N. W. Rep. 890.

(4) *Methods of valuing corporate franchises:* See, especially, note 9 Am. & E. C. C. (N. S.) 710, and article of J. N. Fiero, Esq., in 60 Alb. L. J. 277. In 25 Am. & Eng. Encyc. of Law, p. 635, it is said: "Franchise taxes may be measured, (1) by *dividends* (People v. Alb. Ins. Co., 92 N. Y. 458, 1 Am. & Eng. C. C. 466; People v. Home Ins. Co., 92 N. Y. 328, 3 Am. & Eng. C. C. 363); (2) by *amount of capital stock* (Com. v. Lancaster Bank, 123 Mass. 493); (3), by extent of *business transacted* (same case); (4) by *gross receipts* (State v. Phil., etc., R. Co., 45 Md. 361, 24 Am. Rep. 511); (5) by *net earnings* (Belo v. Forsythe Co., 82 N. C. 415, 33 Am. Rep. 688); (6) by *average amount of deposits* (Com. v. Lancaster Sav. Bk., 123 Mass. 495); (7) by *market value of shares*, less the value of real and personal property (Spring Valley W. W. v. Schottler, 62 Cal. 69, *supra*; (8) by *deduction of the aggregate amount of the equalized or assessed valuation of all tangible property* from the sum of the market or fair cash value of the shares of the capital stock and the market or fair cash value of the debt (exclusive of debt for current expenses): Porter v. Rockford, etc., Co., 76 Ill. 561; State R. Tax Case, 92 U. S. 575; (9) by the amount of original stock actually paid in (Portland Bank v. Apthorp, 12 Mass.

259); (10) by the *market value of the shares* of the capital stock (*Manufacturers' Ins. Co. v. Loud*, 99 Mass. 146); (11) by the *value of life-insurance policies* in effect (*Conn. Mut. L. Ins. Co. v. Com.*, 133 Mass. 161); (12) by the *number of tons of coal mined* (*Kittanning Coal Co. v. Com.*, 79 Pa. St. 100)."

#### Sec. 444. (g) Gross receipts.

#### MR. JUSTICE BRADLEY IN PHILADELPHIA & SOUTHERN STEAMSHIP COMPANY v. PENNSYLVANIA.

1887. IN THE SUPREME COURT OF THE UNITED STATES. 122 U. S. Rep. 326, on 335, 336, 338.

The question which underlies the immediate question in the case is whether the imposition of the tax upon the Steamship Company's receipts amounted to a regulation of, or an interference with, interstate and foreign commerce, and was thus in conflict with the power granted by the constitution to congress? The tax was levied directly upon the receipts derived by the company from its fares and freights for the transportation of persons and goods between different states, and between the states and foreign countries, and from the charter of its vessels which was for the same purpose. This transportation was an act of interstate and foreign commerce. It was the carrying on of such commerce. It was that and nothing else. In view of the decisions of this court it can not be pretended that the state could constitutionally regulate or interfere with that commerce itself. But taxing is one of the forms of regulation. It is one of the principal forms. Taxing the transportation, either by its tonnage, or its distance, or by the number of trips performed, or in any other way, would certainly be a regulation of the commerce, a restriction upon it, a burden upon it. Clearly, this could not be done by the state without interfering with the power of congress. \* \* \*

If, then, the commerce carried on by the plaintiff in error in this case could not be constitutionally taxed by the state, could the fares and freights received for transportation in carrying on that commerce be constitutionally taxed? If the state can not tax the transportation, may it, nevertheless, tax the fares and freights received therefor? Where is the difference? Looking at the substance of things, and not at mere forms, it is very difficult to see any difference. The one thing seems to be tantamount to the other. It would seem to be rather metaphysics than plain logic for the state officials to say to the company: "We will not tax you for the transportation you perform, but we will tax you for what you get for performing it." Such a position can hardly be said to be based on a sound method of reasoning. \* \* \*

The very object of his engaging in transportation is to receive pay for it. If the regulation of the transportation belongs to the power of congress to regulate commerce, the regulation of fares and freights

receivable for such transportation must equally belong to that power; and any burdens imposed by the state on such receipts must be in conflict with it. To apply the language of Chief Justice Marshall, fares and freights for transportation in carrying on interstate or foreign commerce are as much essential ingredients of that commerce as transportation itself. \* \* \*

[After reviewing State Freight Tax, 15 Wall. 232, and Railway Gross Receipts, 15 Wall. 284, and criticising if not overruling the latter.] Held, the tax was a regulation of interstate commerce, and void.

*Note:* See next case.

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**Sec. 445. Same. (h) Excise.**

**MR. JUSTICE FIELD IN MAINE v. GRAND TRUNK RAILWAY COMPANY.<sup>1</sup>**

**1891. IN THE SUPREME COURT OF THE UNITED STATES. 142 U. S. Rep. 217, on 227, 8, 9.**

[The railway company, a foreign corporation, operated a leased railroad, part of which was located in the state of Maine. In 1881, this state provided "an annual excise tax for the privilege of exercising its franchises" upon all corporations operating railroads within the state, to be ascertained by dividing the total gross receipts by the total mileage, to ascertain the average gross receipts per mile; and when these do not exceed \$2,250 per mile, the tax shall be one-fourth of one per cent. upon the total gross receipts in the state; and when between \$2,250 and \$3,000 per mile, the tax shall be one-half of one per cent., and so increasing at the rate of one-fourth of one per cent. for each increase of \$750 per mile.]

The privilege of exercising the franchises of a corporation within a state is generally one of value, and often of great value, and the subject of earnest contention. It is natural, therefore, that the corporation should be made to bear some proportion of the burdens of government. As the granting of the privilege rests entirely in the discretion of the state, whether the corporation be of domestic or foreign origin, it may be conferred upon such conditions, pecuniary or otherwise, as the state in its judgment may deem most conducive to its interests or policy. It may require the payment into its treasury, each year, of a specific sum, or may apportion the amount exacted according to the value of the business permitted, as disclosed by its gains or receipts of the present or past years. The character of the tax, or its validity, is not determined by the mode adopted in fixing its amount for any specific period or the times of its payment. The

<sup>1</sup> Statement abridged, only a small part of opinion given. Dissenting opinion of Bradley, J. (Harlan, Lamar and Brown concurring), omitted.

whole field of inquiry into the extent of revenue from sources at the command of the corporation, is open to the consideration of the state in determining what may be justly exacted for the privilege. The rule of apportioning the charge to the receipts of the business would seem to be eminently reasonable, and likely to produce the most satisfactory results, both to the state and the corporation taxed.

The court below held that the imposition of the taxes was a regulation of commerce, interstate and foreign, and therefore in conflict with the exclusive power of congress in that respect; and on that ground alone it ordered judgment for the defendant. This ruling was founded upon the assumption that a reference by the statute to the transportation receipts and to a certain percentage of the same in determining the amount of the excise tax, was in effect the imposition of the tax upon such receipts, and therefore an interference with interstate and foreign commerce. But a resort to those receipts was simply to ascertain the value of the business done by the corporation, and thus obtain a guide to a reasonable conclusion as to the amount of the excise tax which should be levied; and we are unable to perceive in that resort any interference with transportation, domestic or foreign, over the road of the railroad company, or any regulation of commerce which consists in such transportation. If the amount ascertained were specifically imposed as the tax, no objection to its validity would be pretended. And if the inquiry of the state as to the value of the privilege were limited to receipts of certain past years instead of the year in which the tax is collected, it is conceded that the validity of the tax would not be affected; and if not, we do not see how a reference to the results of any other year could affect its character. There is no levy by the statute on the receipts themselves, either in form or fact; they constitute, as said above, simply the means of ascertaining the value of the privilege conferred. \* \* \*

*Reversed.*

*Note:* See, 1867, *Southern Express Co. v. Hood*, 15 Rich. Law (S. C.) 66, 94 Am. Dec. 141; 1872, *State Tax on Gross Receipts*, 15 Wall. 284; 1878, *Insurance Co. v. Commonwealth*, 87 Pa. St. 173, 30 Am. Rep. 352; 1883, *Worth v. Wilmington, etc., R. Co.*, 89 N. C. 291, 45 Am. Rep. 679; 1887, *Fargo v. Michigan*, 121 U. S. 230; 1888, *Ratterman v. West. U. Tel. Co.*, 127 U. S. 411; 1889, *West. U. Tel. Co. v. Alabama*, 132 U. S. 472; 1892, *Lehigh Valley R. v. Pennsylvania*, 145 U. S. 192; 1895, *Southern Building, etc., Assn. v. Norman*, 98 Ky. 294, 56 Am. St. Rep. 367; 1898, *McHenry v. Alford*, 168 U. S. 651, 670. See note to section 449, *infra*; 1903, *Western U. Tel. Co. v. Gottlieb*, 190 U. S. 412.



**Sec. 446. (i) License.**

**THE STANDARD UNDERGROUND CABLE COMPANY, APPELLANT, V.  
THE ATTORNEY-GENERAL, RESPONDENT.<sup>1</sup>**

**1889. IN THE COURT OF ERRORS AND APPEALS OF NEW JERSEY.  
46 N. J. Eq. Rep. 270-279, 19 Am. St. Rep. 394.**

[Appeal from orders of injunction advised by the vice-chancellor on application of the attorney-general under statutes, to restrain the company from exercising its franchises until taxes were paid. This company was incorporated in New Jersey as a manufacturing company to do business in Pennsylvania, and had an office in New Jersey. The New Jersey law provided that corporations incorporated in the state, but not carrying on its business there, "shall pay a yearly license fee or tax of one-tenth of one per centum on the amount of the capital stock of such corporation." The constitution provided "that property shall be assessed for taxes under general laws, and by uniform rules, according to its true value." It was contended the tax violated this provision.]

KNAPP, J. \* \* \* The fault of this position is the assumption that this tax is one upon property. Such, manifestly, is not the case. The law in question imposes a tax on certain corporations by way of a license for exercising corporate franchises. It is declared to be such tax by the act, and, although it is laid on this class of corporations with respect to the capital stock, the tax possesses the legal quality of a license or franchise tax. *Evening Journal Association v. State Board of Assessors*, 48 N. J. L. 36; *Cooley Tax*. (2d ed.) 379, and cases cited.

Upon the power of the legislature to impose such a tax there exists no restriction in our constitution. As a license or franchise tax, it is not within the equality clause of the constitution referred to.

In those states in the union having constitutional provisions requiring equality in the taxation of property, it is uniformly held that such provisions do not abridge or apply to the legislative power of indirect taxation by taxes on franchises, privileges, trades and occupations: *Cooley Tax*., 176 *et seq.*, and cases cited; *State Board of Assessors v. Central R. Co.*, 48 N. J. L. 146, 356.

It is next insisted that this law is void because it is a regulation of commerce between the states, and an infringement upon the exclusive power of congress over that subject under the provisions of the federal constitution.

This position seems to be based on two grounds: First, that all corporations holding a franchise from one state and performing their functions in another are engaged in interstate commerce; and, second, that the business of this particular corporation, namely, the manufacture of electric cables, is itself internal commerce.

<sup>1</sup> Statement abridged, and only so much of opinion as relates to the single point is given.

These grounds impress me only by their novelty. Our general laws for the organization of corporations permit companies to transact their business in other states. It certainly has not been supposed that the exercise of this right put them beyond the reach of taxation everywhere, or brought them into any relations whatever with the provision in the federal constitution referred to. No case is cited giving the slightest countenance to the notion that to hold a charter from one state, when the corporate property is located, or corporate business transacted, in another state, relieves the corporation in both or either state from taxation in any form which the legislative power may under its state constitution adopt; nor any case in which these conditions are given the slightest consequence in ascertaining the limit of the state power to tax either the property of the corporation where such property has its situs, or its franchises in the state which granted them.

Under the point that the appellant is engaged in, or is an instrument in, interstate commerce, cases in the federal courts are liberally cited in the brief of counsel throwing light on the relation which state taxation holds to the exclusive power of congress to regulate commerce between the states, and defining what is internal commerce, such as is removed from state interference and obstruction. It is scarcely necessary to say that none of those cases gives the slightest countenance to the notion that the manufacture of that which may become a subject of commerce, and which may ultimately pass into protected trade, is commerce itself, or that manufactories of any sort can be instruments in commerce. \* \* \*

*Affirmed.*

*Note: License taxes:* See, 1848, *Mayor, etc., of Baltimore v. B. & O. R.*, 6 Gill. 288, 48 Am. Dec. 531; 1870, *Erie R. Co. v. Commonwealth*, 66 Pa. St. 84, 5 Am. Rep. 351; 1874, *Railroad Company v. Maryland*, 21 Wall. (U. S.) 456; 1876, *Western U. Tel. Co. v. State*, 9 Baxter (Tenn.) 509, 40 Am. Rep. 99; 1888, *Western U. Tel. Co. v. Massachusetts*, 125 U. S. 530; 1889, *Commonwealth v. N. Y., etc., R. Co.*, 129 Pa. St. 463, 15 Am. St. Rep. 724; 1890, *Bell's Gap R. v. Pennsylvania*, 134 U. S. 232; 1890, *New Orleans v. Orleans R. Co.*, 42 La. Ann. 4, 21 Am. St. Rep. 365; 1892, *New Orleans, etc., Co. v. New Orleans*, 143 U. S. 192; 1892, *Horn Silver Min. Co. v. New York*, 143 U. S. 305; 1895, *Denver, etc., R. Co. v. Denver*, 21 Colo. 350, 52 Am. St. Rep. 239; 1897, *Phoenix Carpet Co. v. State*, 118 Ala. 143, 72 Am. St. Rep. 143. See, also, notes, 25 Am. St. Rep. 870, 885, and note, *infra*, section 447.

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**Sec. 447. (j) Privilege of engaging in interstate commerce.**

**NORFOLK & WESTERN RAILROAD COMPANY v. PENNSYLVANIA.<sup>1</sup>**

1889. IN THE SUPREME COURT OF THE UNITED STATES. 136 U. S. Rep. 114-120.

[An act of the legislature of Pennsylvania, June 7, 1879, provided that thereafter no foreign corporation which does not invest and use

<sup>1</sup>Statement abridged; part of opinion omitted.

its capital in the state, shall have an office in the state for the use of its officers, stockholders, agents or employes, unless it shall have obtained an annual license so to do from the auditor-general, for which it shall pay annually one-fourth of one mill on each dollar capital stock which it is authorized to have,—and the license shall not issue until this fee is paid. Under this act the auditor-general assessed a license tax against the railroad company upon its capital stock of \$25,000,000, on account of its having an office at Philadelphia. There was a special finding of facts that the railroad company existed under the laws of Virginia and West Virginia, and all its lines lay wholly within these states; its lines, however, connect with others at various points, so that “by virtue of these connections and certain traffic contracts and agreements, it has become a link in a through line of road, over which, as part of the business thereof, freight and passengers are carried into and out of this commonwealth.” The main office was at Roanoke, Va., but it maintained an office in Philadelphia “for the use of its officers, stockholders, agents and employes.” Except in this way it owned no property, and had no capital invested for corporate purposes in Pennsylvania. It refused to pay the license fee, and judgment was rendered against the company; this was affirmed by the supreme court, and this writ of error sued out, on the ground that it had been denied its rights as a citizen “entitled to all the privileges of citizens of the several states” under article IV of the constitution of the United States; also the “equal protection of the laws” under the fourteenth amendment, and that the law violated the constitutional power of congress to regulate commerce among the states.]

MR. JUSTICE LAMAR: \* \* \* [After ruling against the railroad company on the first two points, as having been settled by *Pembina Min. Co. v. Pennsylvania*, 125 U. S. 181].

The only question for consideration, therefore, arises under the third assignment of error, above set forth. It is well settled by numerous decisions of this court, that a state can not, under the guise of a license tax, exclude from its jurisdiction a foreign corporation engaged in interstate commerce, or impose any burdens upon such commerce within its limits. Some of the cases sustaining this proposition are collected in *McCall v. California*, just decided, 136 U. S. 104, and need not be repeated here.

The question before us is thus narrowed to the two following inquiries: (1) Was the business of this company in the state of Pennsylvania interstate commerce? (2) If so, was the tax assessed against it for keeping an office in Philadelphia, for the use of its officers, stockholders, agents and employes, a tax upon such business? We have no difficulty in answering the first of these inquiries in the affirmative. Although the findings of fact are somewhat meager on this question—much more so, indeed, than the undisputed evidence in the case warranted—enough is stated in the second paragraph of the aforesaid finding to show that the company is engaged in interstate commerce in the state. It is there said, in substance: By virtue of its connections and certain traffic contracts with other railroads the Norfolk and

Western Railroad Company "has become a link in a through line of road, over which, as part of the business thereof, freight and passengers are carried into and out of this commonwealth." That is to say, the business of the through line of railroad, of which the plaintiff in error forms a part or in which it is a link, consists, in a measure, of carrying passengers and freight into Pennsylvania from other states, and out of that state into other states. It certainly requires no citation of authorities to demonstrate that such business—that is, the business of this through line of railroad—is interstate commerce. That being true, it logically follows that any one of the roads forming a part of, or constituting a link in, that through line, is engaged in interstate commerce, since the business of each one of those roads serves to increase the volume of business done by that through line.

On this point *The Daniel Ball*, 10 Wall. 557, 565, is an authority. In that case the steamer *Daniel Ball* was engaged in transporting goods on Grand river, wholly within the state of Michigan, destined for other states, and goods brought from other states destined for places in the state of Michigan, but did not run in connection with, or in continuation of, any line of vessels or railway leading to other states; and the contention was, that she was not engaged in interstate commerce. But this court held otherwise, and said: "So far as she was employed in transporting goods destined for other states, or goods brought from without the limits of Michigan and destined to places within that state, she was engaged in commerce between the states, and however limited that commerce may have been she was, so far as it went, subject to the legislation of congress. She was employed as an instrument of that commerce; for whenever a commodity has begun to move as an article of trade from one state to another, commerce in that commodity between the states has commenced. The fact that several different and independent agencies are employed in transporting the commodity, some acting entirely in one state, and some acting through two or more states, does in no respect affect the character of the transaction. To the extent in which each agency acts in that transportation, it is subject to the regulation of congress." See, also, *Wabash, etc., Railway Co. v. Illinois*, 118 U. S. 557, and cases cited.

We pass to the second inquiry above stated, viz.: Was the tax assessed against the company for keeping an office in Philadelphia, for the use of its officers, stockholders, agents and employes, a tax upon the business of the company? In other words, was such tax a tax upon any of the *means* or *instruments* by which the company was enabled to carry on its business of interstate commerce? We have no hesitancy in answering that question in the affirmative. What was the purpose of the company in establishing an office in the city of Philadelphia? Manifestly for the furtherance of its business interests in the matter of its commercial relations. One of the terms of the contract by which the plaintiff in error became a link in the through line of road referred to in the findings of fact, provided that "it shall be the duty of each initial road, member of the line, to

solicit and procure traffic for the Great Southern Despatch (the name of said through line) at its own proper cost and expense." Again, the plaintiff in error does not exercise, or seek to exercise, in Pennsylvania any privilege or franchise not immediately connected with interstate commerce and required for the purposes thereof. Before establishing its office in Philadelphia it obtained from the secretary of the commonwealth the certificate required by the act of the state legislature of 1874 enabling it to maintain an office in the state. That office was maintained because of the necessities of the interstate business of the company, and for no other purpose. A tax upon it was, therefore, a tax upon one of the means or instrumentalities of the company's interstate commerce; and as such was in violation of the commercial clause of the constitution of the United States. *Gloucester Ferry Co. v. Pennsylvania*, 114 U. S. 196; *Philadelphia Steamship Co. v. Pennsylvania*, 122 U. S. 326, and cases cited; *McCall v. California*, just decided, 136 U. S. 104.

*Reversed.*

MR. CHIEF JUSTICE FULLER, MR. JUSTICE GRAY and MR. JUSTICE BREWER, dissented.

*Note.* Compare, 1868, *Attorney-General v. Bay State, etc., Co.*, 99 Mass. 148, 96 Am. Dec. 717, note 720; 1890, *McCall v. California*, 136 U. S. 104; 1891, *Crutcher v. Kentucky*, 141 U. S. 47; 1892, *People v. Wemple*, 131 N. Y. 64, 27 Am. St. Rep. 542, note; 1897, *McNaughton Co. v. McGirl*, 20 Mont. 124, 63 Am. St. Rep. 610; 1900, *Williams v. Fears*, 179 U. S. 270. See, also, notes, 25 Am. St. Rep. 870-890, 27 Am. St. Rep. 547-568; 60 L. R. A. 641.

#### Sec. 448. (k) Equal protection of the laws in taxation.

SEE THE RAILROAD TAX CASES, 13 Fed Rep. 722, *supra*, p. 36.

*Note.* See, 1851, *Commonwealth v. Milton*, 12 B. Mon. (Ky.) 212, 54 Am. Dec. 522; 1864, *Erie Railway Co. v. State*, 2 Vroom (N. J.) 531, 86 Am. Dec. 226; 1868, *Phoenix Ins. Co. v. Commonwealth*, 5 Bush (Ky.) 68, 96 Am. Dec. 331; 1885, *Santa Clara Co. v. So. Pac. R. Co.*, 118 U. S. 394; 1885, *Kentucky R. Tax Cases*, 115 U. S. 321; 1887, *San Francisco v. Liverpool Ins. Co.*, 74 Cal. 113, 5 Am. St. Rep. 425; 1888, *Pembina, etc., Min. Co. v. Pennsylvania*, 125 U. S. 181; 1888, *Missouri Pac. R. Co. v. Mackey*, 127 U. S. 205; 1889, *Minneapolis, etc., R. Co. v. Beckwith*, 129 U. S. 26; 1890, *Bell's Gap R. Co. v. Pennsylvania*, 134 U. S. 232; 1892, *Pacific Express Co. v. Seibert*, 142 U. S. 339; 1897, *St. Louis, etc., Railway Co. v. Paul*, 64 Ark. 83, 62 Am. St. Rep. 154; *West. Union Tel. Co. v. Indiana*, 165 U. S. 304; 1897, *Gulf, etc., R. Co. v. Ellis*, 165 U. S. 150; 1897, *Knoxville & S. R. R. Co. v. Harris*, 99 Tenn. 684, 53 L. R. A. 921; 1898, *New York v. Roberts*, 171 U. S. 658; 1898, *Pittsburgh, etc., R. Co. v. Montgomery*, 152 Ind. 1, 71 Am. St. Rep. 301; 1900, *Am. Sug. Ref. Co. v. Louisiana*, 179 U. S. 89; 1900, *People, etc., ex rel. N. Y. Clearing House, etc., v. Roberts*, 179 U. S. 279; 1900, *Reyman Brewing Co. v. Brister*, 179 U. S. 445. See, also, note, *supra*, p. 56 and note, 62 Am. St. Rep. 165, 175; 60 L. R. A. 321.

**Sec. 449. (1) Government agencies.****TELEGRAPH COMPANY v. TEXAS.<sup>1</sup>**

**1881. IN THE SUPREME COURT OF THE UNITED STATES. 105 U. S. Rep. 460-466.**

[Error to the supreme court of Texas. The Western Union Telegraph had accepted the provisions of the act of congress authorizing it to use the public domain and the United States military and post roads, and in consideration therefor had bound itself to give the United States precedence in the use of its lines for public business at rates to be fixed by the postmaster-general, and had thereby become a government agent for the transmission of messages concerning public business. The company had 125 offices in Texas. Pursuant to a provision in the Texas constitution authorizing an occupation tax, the legislature of that state imposed a tax of one cent upon each full rate, and one-half cent upon each less than full rate message, sent from offices in the state; many of the messages sent went to places outside of the state, and many were sent by United States government officers. The supreme court of Texas sustained the tax.]

**MR. CHIEF JUSTICE WAITE:** In *Pensacola Telegraph Co. v. Western Union Telegraph Co* (96 U. S. 1), this court held that the telegraph was an instrument of commerce, and that telegraph companies were subject to the regulating power of congress in respect to their foreign and interstate business. A telegraph company occupies the same relation to commerce as a carrier of messages, that a railroad company does as a carrier of goods. Both companies are instruments of commerce, and their business is commerce itself. \* \* \*

In *Case of the State Freight Tax* (15 Wall. 232) this court decided that a law of Pennsylvania requiring transportation companies doing business in that state to pay a fixed sum as a tax "on each two thousand pounds of freight carried," without regard to the distance moved, or charge made, was unconstitutional, so far as it related to goods taken through the state, or from points without the state to points within, or from points within to points without, because to that extent it was a regulation of foreign and interstate commerce. In this the court but applied the rule, announced in *Brown v. Maryland* (12 Wheat. 419), that where the burden of a tax falls on a thing which is the subject of taxation, the tax is to be considered as laid on the thing rather than on him who is charged with the duty of paying it into the treasury. In that case, it was said, a tax on the sale of an article, imported only for sale, was a tax on the article itself. To the same general effect are *Welton v. State of Missouri*, 91 U. S. 275; *Cook v. Pennsylvania*, 97 U. S. 566; and *Webber v. Virginia*, 103 U. S. 344. Taxes upon passenger carriers of a specific amount for each passenger carried were held to be taxes on the passengers, in *Passenger Cases*, 7 How. 283; *Crandall v. State of Nevada*, 6 Wall. 35;

<sup>1</sup> Statement abridged; arguments and part of opinion omitted.

<sup>2</sup> WIL. CAS.—15.



and *Henderson v. The Mayor*, 92 U. S. 259. Taxes on vessels according to measurement, without any reference to value, were declared to be taxes on tonnage. *State Tonnage Cases*, 12 Wall. 204; *Peete v. Morgan*, 19 Wall. 581; *Cannon v. New Orleans*, 20 Wall. 577; and *Inman Steamship Co. v. Tinker*, 94 U. S. 238.

The present case, as it seems to us, comes within this principle. The tax is the same on every message sent, and because it is sent, without regard to the distance carried or the price charged. It is in no respect proportioned according to the business done. If the message is sent the tax must be paid, and the amount determined solely by the class to which it belongs. If it is full rate the tax is one cent, and if less than full rate, one-half cent. Clearly if a fixed tax for every two thousand pounds of freight carried is a tax on the freight, or for every measured ton of a vessel a tax on tonnage, or for every passenger carried a tax on the passenger, or for the sale of goods a tax on the goods, this must be a tax on the messages. As such, so far as it operates on private messages sent out of the state, it is a regulation of foreign and interstate commerce and beyond the power of the state. That is fully established by the cases already cited. As to the government messages, it is a tax by the state on the means employed by the government of the United States to execute its constitutional powers, and, therefore, void. It was so decided in *McCulloch v. Maryland* (4 Wheat. 316) and has never been doubted since.

\* \* \*

[Holding, however, that the tax upon messages sent between places in the state, and not on government business, would be valid.]

*Reversed.*

*Note:* As to taxation of interstate, or government agencies: See

*Telegraph companies:* 1876, *Western U. Tel. Co. v. State*, 9 Baxter (Tenn.) 509, 40 Am. Rep. 99, note 104; 1888, *Western U. Tel. Co. v. Massachusetts*, 125 U. S. 530; 1891, *Massachusetts v. Western U. Tel. Co.*, 141 U. S. 40; 1895, *Postal Tel. Co. v. Adams*, 155 U. S. 688; 1895, *Western Union Tel. Co. v. Taggart*, 163 U. S. 1, 4 Am. & E. C. C. (N. S.) 412; 1903, *Western Union Tel. Co. v. Gottlieb*, 190 U. S. 412; 1903, *Atlantic & Pac. Co. v. Philadelphia*, 190 U. S. 160.

*Interstate bridges:* 1861, *O'Neal v. Virginia B. Co.*, 18 Md. 1, 79 Am. Dec. 669; 1878, *Quincy R. Bridge v. Adams Co.*, 88 Ill. 615, *supra*, p. 988; 1888, *Buttenuth v. St. Louis Bridge Co.*, 123 Ill. 535, 5 Am. St. Rep. 545; 1891, *Henderson Bridge Co. v. Henderson*, 141 U. S. 679; 1894, *Chicago & Alton R. v. People*, 153 Ill. 409, 29 L. R. A. 69, note; 1897, *Henderson Bridge Co. v. Kentucky*, 166 U. S. 150.

*National banks:* See, generally, only so far as allowed by act of congress: 1819, *McCulloch v. Maryland*, 4 Wheat. 316; 1824, *Osborn v. Bank of U. S.*, 9 Wheat. 738; 1864, *Bank Tax Case*, 2 Wall. (U. S.) 200; 1865, *Van Allen v. Assessors*, 3 Wall. (U. S.) 573; 1875, *Farmers' Nat'l Bank v. Dearing*, 91 U. S. 29; 1879, *People v. Weaver*, 100 U. S. 539; 1897, *Aberdeen Bank v. Chehalis Co.*, 166 U. S. 440; 1898, *People v. National Bank*, 123 Cal. 53, 69 Am. St. Rep. 32; 1899, *National Bank v. Chapman*, 173 U. S. 205; 1900, *First National Bank v. Turner*, 154 Ind. 456, 57 N. E. Rep. 110; 1900, *Jenkins v. Neff*, 163 N. Y. 320. See especially, notes, 69 Am. St. Rep. 38, and 45 L. R. A. 737.

**Sec. 450. (m) Situs of shares for taxation.****TAPPAN, COLLECTOR, v. MERCHANTS' NATIONAL BANK.<sup>1</sup>**

1873. IN THE SUPREME COURT OF THE UNITED STATES. 86 U. S.  
(19 Wall.) Rep. 490-505.

[Appeal from circuit court. Suit by the bank to enjoin the collection of taxes upon shares of the bank assessed under the Illinois act of 1867, providing shareholders should be taxed in the county where the bank was located. The national act under which the bank was formed provided for taxing the shares of non-residents by the state, "in the city or town where the bank is located," but at a rate not greater than is assessed upon other moneyed capital in the hands of individual citizens of the state. The state constitution provided that the taxes assessed in the various counties shall "be uniform in respect to persons and property," and upon all the property therein. The bank was located in Cook county, some of its shareholders residing there, others elsewhere within the state, and still others out of the state. It was contended that the constitution required shareholders not residing in Cook county to be taxed at their residence,—hence they could not be taxed at the bank in Cook county; and since the law of 1867 required all to be taxed in Cook county, those within the county were improperly taxed, if those out of the county were not properly taxed; and since those within the state were not validly taxed, those out of the state were not. This presented the validity of the act of 1867.]

MR. CHIEF JUSTICE WAITE: We are called upon in this case to determine whether the general assembly of the state of Illinois could, in 1867, provide for the taxation of the owners of shares of the capital stock of a national bank in that state, at the place, within the state, where the bank was located, without regard to their places of residence. The statute of Illinois, under the authority of which the taxes complained of were assessed, was passed before the act of congress, approved February 10, 1868, which gave a legislative construction to the words, "place where the bank is located, and not elsewhere," as used in section 41 of the national banking act, and permitted the state to determine and direct the manner and place of taxing resident shareholders, but provided that non-residents should be taxed only in the city or town where the bank was located.

The power of taxation by any state is limited to persons, property, or business within its jurisdiction. Personal property, in the absence of any law to the contrary, follows the person of the owner, and has its situs at his domicile. But, for the purposes of taxation, it may be separated from him, and he may be taxed on its account at the place where it is actually located. These are familiar principles, and have been often acted upon in this court and in the courts of Illinois. If

<sup>1</sup> Statement abridged; arguments and part of opinion omitted. For a vigorous criticism of this case, see Waples Law of Debtor and Creditor, relative to The Situs of Debt, p. 138, *et seq.*

the state has actual jurisdiction of the person of the owner, it operates directly upon him. If he is absent, and it has jurisdiction of his property, it operates upon him through his property.

Shares of stock in national banks are personal property. They are made so in express terms by the act of congress under which such banks are organized. They are a species of personal property which is, in one sense, intangible and incorporeal, but the law which creates them may separate them from the person of their owner for the purposes of taxation, and give them a situs of their own. This has been done. By section 41 of the national banking act it is in effect provided that all shares in such banks, held by any person or body corporate, may be included in the valuation of the personal property of such person or corporation in the assessment of taxes imposed under state authority, at the place where the bank is located, and not elsewhere. This is a law of the property. Every owner takes the property subject to this power of taxation under state authority, and every non-resident, by becoming an owner, voluntarily submits himself to the jurisdiction of the state in which the bank is established for all the purposes of taxation on account of his ownership. His money invested in the shares is withdrawn from taxation under the authority of the state in which he resides and submitted to the taxing power of the state where, in contemplation of the law, his investment is located. The state, therefore, within which a national bank is situated has jurisdiction, for the purposes of taxation, of all the shareholders of the bank, both resident and non-resident, and of all its shares, and may legislate accordingly.

The state of Illinois thus having had, in 1867, the right to tax all the shareholders of national banks in that state on account of their shares, it remains to consider at what place or places within the state such taxes could be assessed.

It is conceded that it was within the power of the state to tax the shares of non-resident shareholders at the place where the bank was located, but it is claimed that under the constitution of the state resident shareholders could only be taxed at the places of their residence.  
\* \* \*

This power of locating personal property for the purpose of taxation without regard to the residence of the owner has been often exercised in Illinois, and sustained by the courts. \* \* \*

We do not understand the counsel for the appellee to dispute this power, where the property is tangible and capable of having, so to speak, an actual situs of its own, but he claims that if it is intangible it can not be separated from the person of its owner. It must be borne in mind that all this property, intangible though it may be, is within the state. That which belongs to non-residents is there by operation of law. That which belongs to residents is there by reason of their residence. All the owners have submitted themselves to the jurisdiction of the state, and they must obey its will when kept within the limits of constitutional power.

The question is then presented whether the general assembly, hav-

ing complete jurisdiction over the person and the property, could separate a bank share from the person of the owner for the purposes of taxation. It has never been doubted that it was a proper exercise of legislative power and discretion to separate the interest of a partner in partnership property from his person for that purpose, and to cause him to be taxed on its account at the place where the business of the partnership was carried on. And this, too, without reference to the character of the business or the property. The partnership may have been formed for the purpose of carrying on mercantile, banking, brokerage, or stock business. The property may be tangible or intangible, goods on the shelf or debts due for goods sold. The interest of the partner in all the property is made taxable at the place where the business is located.

A share of bank stock may be in itself intangible, but it represents that which is tangible. It represents money or property invested in the capital stock of the bank. That capital is employed in business by the bank, and the business is very likely carried on at a place other than the residence of some of the shareholders. The shareholder is protected in his person by the government at the place where he resides; but his property in this stock is protected at the place where the bank transacts his business. If he were a partner in a private bank doing business at the same place, he might be taxed there on account of his interest in the partnership. It is not easy to see why, upon the same principle, he may not be taxed there on account of his stock in an incorporated bank. His business is there as much in the one case as in the other. He requires for it the protection of the government there, and it seems reasonable that he should be compelled to contribute there to the expenses of maintaining that government. It certainly can not be an abuse of legislative discretion to require him to do so. If it is not, the general assembly can rightfully locate his shares there for the purposes of taxation.

But it is said to be a violation of the constitutional rule of uniformity to compel the owner of a bank share to submit to taxation for this part of his property at a place other than his residence, because other residents are taxed for their personal property where they reside. It is a sufficient answer to this proposition to say that all persons owning the same kind of property are taxed as he is taxed. \* \* \*

*Reversed.*

*Note.* Situs of corporate stock and bonds for purposes of taxation.

(a) In the absence of provisions to the contrary, the situs of shares in either domestic or foreign corporations is the domicile of the owner: 1852, *New Albany v. Meekin*, 3 Ind. 481, 56 Am. Dec. 522, note 528; 1865, *McKeen v. County of Northampton*, 49 Pa. St. 519, 88 Am. Dec. 515; 1866, *Dwight v. Mayor*, 12 Allen (Mass.) 316, 90 Am. Dec. 149; 1876, *Dyer v. Osborne*, 11 R. I. 321, 23 Am. Rep. 460; 1880, *Bradley v. Bauder*, 36 O. S. 28, 38 Am. Rep. 547; 1880, *Worth v. Ashe*, 82 N. C. 420, 33 Am. Rep. 692; 1889, *South Nashville St. R. Co. v. Morrow*, 87 Tenn. 406, 2 L. R. A. 853; 1894, *Commonwealth v. Charlottesville, etc., Co.*, 90 Va. 790, 44 Am. St. Rep. 950; 1900, *Greenleaf v. Board of Revenue*, 184 Ill. 226, 75 Am. St. Rep. 168; 1900, *State v. Kidd*, — Ala. —, 28 So. Rep. 480; 1901, *Bacon v. Board Tax Commrs.*, 126 Mich. 22, 86 Am. St. R. 524.

(b) The state, however, may provide that shares in its own corporations owned by either residents or non-residents shall be taxed at the domicile of the corporation, — even though the non-resident owner is required to pay tax on the same shares at his own domicile: 1876, *Ottawa Glass Co. v. McCaleb*, 81 Ill. 556; 1880, *Bradley v. Bauder*, 36 O. S. 28, 38 Am. Rep. 547; 1882, *American Coal Co. v. Commissioners*, 59 Md. 185; 1884, *St. Albans v. Car-Co.*, 57 Vt. 68; 1889, *South Nash. St. R. v. Morrow*, 87 Tenn. 406, 2 L. R. A. 853; 1892, *Wiley v. Commissioners*, 111 N. C. 397; 1896, *Matter of Bronson*, 150 N. Y. 1, 55 Am. St. Rep. 632; 1898, *Scandinavian Am. Bk. v. Pierce Co.*, 20 Wash. 155, 55 Pac. 40; compare, 1836, *Union Bank v. State*, 9 Yerg. (Tenn.) 490; 1886, *Young v. South Tredegar, etc., Co.*, 85 Tenn. 189, 4 Am. St. Rep. 752. See notes, 56 Am. Dec. 528, 62 Am. St. 458.

(c) *Bonds, bills, notes, credits, etc.* See, generally, note 62 Am. St. Rep. 448. The general rule is that the situs of these is the domicile of the creditor, and they are taxable only there: 1871, *Hunter v. Supervisors*, 33 Iowa 376, 11 Am. Rep. 132; 1872, *State Tax on Foreign-held Bonds*, 15 Wall. (U. S.) 300; 1877, *Herron v. Keeran*, 59 Ind. 472, 26 Am. Rep. 87; 1888, *Commonwealth v. Am. Dredging Co.*, 122 Pa. St. 386, 9 Am. St. Rep. 116; 1889, *South Nashville St. R. Co. v. Morrow*, 87 Tenn. 406, 2 L. R. A. 853; 1896, *Matter of Bronson*, 150 N. Y. 1, 55 Am. St. Rep. 632; 1896, *Mackay v. San Francisco*, 113 Cal. 892; 1899, *Balk v. Harris*, 124 N. C. 467, 70 Am. St. Rep. 606; 1900, *In re Fair's Estate*, 128 Cal. 607, 61 Pac. Rep. 184; 1900, *Mackay v. City and Co. of San Fran.*, 128 Cal. 678, 61 Pac. Rep. 382.

But if the bonds, notes, moneys, credits, etc., are actually in the state, and used there for business purposes, they have a situs there for the purpose of taxation, without regard to domicile of either debtor or creditor: 1875, *Wilcox v. Ellis*, 14 Kan. 588, 19 Am. Rep. 107; 1886, *Finch v. County of York*, 19 Neb. 50, 56 Am. Rep. 741; 1894, *State v. Hamlin*, 86 Me. 495, 41 Am. St. Rep. 569, note 583; 1896, *Matter of Houdayer*, 150 N. Y. 37, 55 Am. St. Rep. 642; 1896, *Matter of Whiting*, 150 N. Y. 27, 55 Am. St. Rep. 640; 1897, *Buck v. Miller*, 147 Ind. 586, 62 Am. St. Rep. 436, note 448; 1899, *State v. Scottish-Am. Mtg. Co.*, 76 Minn. 155, 78 N. W. Rep. 962; 1899, *Hubbard v. Brush*, 61 O. S. 252, 55 N. E. Rep. 829; 1899, *New Orleans v. Stempel*, 175 U. S. 309; 1903, *State Board of Assessors v. Comptoir National*, 191 U. S. 388.

(d) *Taxation of corporate indebtedness*: See the following cases: 1870, *Pittsburgh, Ft. W. & C. R. Co. v. Commonwealth*, 66 Pa. St. 73, 5 Am. Rep. 344; 1889, *Commonwealth v. N. Y., etc., R. Co.*, 129 Pa. St. 463, 15 Am. St. Rep. 724; 1889, *Commonwealth v. Lehigh Valley R.*, 129 Pa. St. 429; 1889, *Commonwealth v. N. Y., etc., R.*, 129 Pa. St. 478; 1889, *Commonwealth v. Del., etc., Canal Co.*, 123 Pa. St. 594, 2 L. R. A. 798, note; 1890, *Bell's Gap R. v. Pennsylvania*, 134 U. S. 232; 1894, *N. Y., etc., R. Co. v. Pennsylvania*, 153 U. S. 628; 1895, *Delaware, etc., Canal Co. v. Pennsylvania*, 156 U. S. 200.

## Sec. 451. (n) Taxation of shares held by aliens.

### STATE V. TRAVELERS' INSURANCE COMPANY.<sup>1</sup>

1898. IN THE SUPREME COURT OF ERRORS OF CONNECTICUT. 70  
Conn. Rep. 590-605, 66 Am. St. Rep. 138.<sup>2</sup>

[Action to recover tax upon shares of non-resident shareholders. The list of shareholders out of the state did not give the place of residence of any of them, and the omission was not waived, nor was it

<sup>1</sup> Statement abridged. Only the part of the opinion relating to the single point is given.

<sup>2</sup> Affirmed, — U. S. —, 22 Sup. Ct. 673, 46 L. Ed. —.



conceded that the rights of citizens of other states were involved. Non-resident shareholders were taxed in a different way and at a different rate from the resident shareholders. The complaint was demurred to as violating Art. IV of, and the XIVth Amendment to, the United States Constitution. The lower court overruled the demurrer.]

BALDWIN, J. \* \* \* The shares held by residents are taxable at such rates as the towns, cities and boroughs, to which they belong, may, from time to time, see fit to impose, upon a valuation set by the local assessors. The shares held by non-residents are taxable at the fixed rate of one and a half per cent. upon their market value, as determined by the state board of equalization.

It is nowhere stated upon the record that any of the non-resident shareholders in the defendant company are citizens of the United States or of any one of them. Their names only are given, and while we may take judicial notice that these are those of persons belonging to an English speaking race, we can not assume, as a cause for reversing the judgment rendered by the superior court, that they are Americans any more than that they are Englishmen. The provision of the constitution of the United States that the citizens of each state shall be entitled to all privileges and immunities of citizens in every other must, therefore, be laid out of the case.

Regarding the shareholders in question simply as so many persons, residing without this state, there can be no ground for claiming that they can not be charged with the tax in controversy by reason of the declaration in the fourteenth amendment to the constitution, that no state shall deny to any person within its jurisdiction the equal protection of the laws. This inhibition is only for the benefit of persons who are physically present within the territorial jurisdiction of the state, the protection of whose laws they invoke. *Yick Wo v. Hopkins*, 118 U. S. 356, 369. The same is true of the act of congress, U. S. Rev. Stat., § 1977, passed under the authority of the fourteenth amendment, by which it is provided that "all persons within the jurisdiction of the United States shall have the same right in every state \* \* \* to the full and equal benefit of all laws and proceedings for the security of persons and property as is enjoyed by white citizens, and shall be subject to like \* \* \* taxes, licenses, and exactions of every kind, and to no other." The rights thus secured, are those only of persons who at the time are within the jurisdiction, that is, within the territory or under the flag of the United States.

A state has a right to debar aliens (and, as has been stated, it does not appear that any Americans are among the non-resident stockholders in the defendant company) from holding shares in her corporations, or to admit them to that privilege only on such terms as she may prescribe. The right of association under the protection of an artificial personality, and of doing business on its credit, whether it be obtained by a special charter or under a general incorporation law, is a franchise granted by the state to such, and such only, as she may deem fit to be entrusted with its exercise. Whatever may be the law as to citizens of other states, aliens can be excluded from membership.



in such bodies, unless they enter them on conditions which subject their investments to such burdens of taxation as the legislature may think it proper to impose. *Mager v. Grima*, 8 How. 490, 494. \* \* \*

*Affirmed.*

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**Sec. 452. (o) National taxation of state corporations.**

See *Veazie Bank v. Fenno*, 8 Wall. 533, *infra*, p. 1527; *Casey v. Galli*, 94 U. S. 673, *infra*, p. 1529.

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**Sec. 453. 2. Legislative control—extraordinary.<sup>1</sup>**

(1) Repeal.

(a) Power of parliament.

“By the theory of the British constitution, parliament is omnipotent; and hence, an act of that body would undoubtedly be effectual to the dissolution of a corporation. It is to the honor of the British nation, however, that this power, restrained by public opinion, rests mainly in theory; and except in the instances of the suppression of the order of Templars, in the time of Edward the Second, and of the religious houses in the time of Henry the Eighth, we know of no occasion on which parliament have thought proper to dissolve or confirm the arbitrary dissolution of corporate bodies. When, in 1783, a bill was introduced for the purpose of remodeling the charter of the East India Company, it was opposed by Mr. Pitt and Lord Thurlow, not only as a dangerous violation of the charter of the company, but as a total subversion of the law and constitution of the country. In the nervous language of the latter, it was ‘an atrocious violation of private property, *which cut every Englishman to the bone.*’ \* \* \* It is a happy feature in the constitution of our own government, that the power of the legislatures of the different states resembles, in this particular, the prerogative of the king of Great Britain, who may create, but can not dissolve, a corporation, or, without its consent, alter or amend its charter.” *Angell & Ames Corp.*, § 767.

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**Sec. 454. (b) Power of congress.<sup>2</sup>**

See *Mormon Church v. United States*; *Romney v. United States*, 136 U. S. 1, *supra*, p. 906.

<sup>1</sup> See *supra*, § 408.

<sup>2</sup> See *supra*, §§ 406, 407, 408, 409.

Sec. 455. Same.

SINKING FUND CASES.<sup>1</sup>

UNION PACIFIC RAILROAD COMPANY v. UNITED STATES.

CENTRAL PACIFIC RAILROAD COMPANY v. GALLATIN.

1878. IN THE SUPREME COURT OF THE UNITED STATES. 99 U. S.  
Rep. 700-769.

[Appeals from the court of claims, and from the circuit court, upon decisions, finding, in the one case, the United States to be entitled to retain and place in a sinking fund certain sums due the Union Pacific Railroad Company for services rendered, and in the other that the Central Pacific Company should pay into the sinking-fund a certain per cent. of its net earnings before paying dividends. The Union Pacific Company was chartered by congress in 1862, with authority to build a railroad from Missouri to California; for each mile built the United States issued to the company \$16,000 of subsidy bonds, bearing six per cent. interest, to be a first mortgage upon the property of the company, and to be repaid by it to the United States in thirty years. During this period all amounts due to the company for services rendered, and five per cent. of the net earnings, to be paid after the road was finished, should be credited upon the interest paid by the government upon the subsidy bonds.

In 1864 the act of 1862 was amended so that the company could issue an equal amount of its own first mortgage bonds, due in thirty years, to be a lien prior to that of the government; it was further provided that only half of the sums due for government services should be credited toward paying the interest upon the subsidy bonds. This act provided "that congress may at any time alter, amend or repeal this act." In 1878 there were outstanding over \$27,000,000 first mortgage bonds; over \$27,000,000 subsidy bonds; and more than \$20,000,000 other bonds; the government had already paid over \$10,000,000 interest upon the subsidy bonds, over and above all sums credited upon such payments. The earnings of the company had been such that, after paying interest upon all but the government bonds, large dividends had been paid upon the \$36,000,000 capital stock, without making any provision for paying the bonds when due. The conditions of the Central Pacific Company were similar. Under these circumstances the act of congress of 1878 required the net earnings of these companies to be ascertained by deducting from the gross earnings the actual operating expenses, and the interest upon the first mortgage bonds, but not the interest upon other debts; and required that *all* sums due for transportation for the government be reserved by the government, one-half to be credited upon interest paid, and one-half put in a sinking-fund in the United States treasury, together

<sup>1</sup> Statement much abridged. Part of opinion of Waite, C. J., and all of dissenting opinions of Strong and Field, JJ., omitted. Only small part of dissenting opinion of Bradley, J., given.

with such further sum paid annually as, with the five per cent. net earnings and sums due for transportation, shall make twenty-five per cent. of the net earnings, all to be properly invested, accumulated, and held for the protection of all lienholders, to meet their claims when due; provided, however, that when the seventy-five per cent. of net earnings are insufficient to pay the interest upon liens prior to that of the government, the secretary of the treasury may remit such part of the twenty-five per cent. as may be necessary to meet the deficiency. It was also provided that no dividend should be declared or paid until the foregoing sinking-fund is fully provided for, and officers and shareholders who participate in declaring or receiving such dividends in violation of these provisions shall be liable to a penalty of \$10,000 and imprisonment for one year. The act was declared to be an amendment of the act of 1864.]

MR. CHIEF JUSTICE WAITE: The single question presented by the case of the Union Pacific Railroad Company is as to the constitutionality of that part of the act of May 7, 1878, which establishes in the treasury of the United States a sinking fund. The validity of the rest of the act is not necessarily involved. \* \* \*

The United States can not any more than a state interfere with private rights, except for legitimate governmental purposes. They are not included within the constitutional prohibition which prevents states from passing laws impairing the obligation of contracts, but equally with the states they are prohibited from depriving persons or corporations of property without due process of law. They can not legislate back to themselves, without making compensation, the lands they have given this corporation to aid in the construction of its railroad. Neither can they by legislation compel the corporation to discharge its obligations in respect to the subsidy bonds otherwise than according to the terms of the contract already made in that connection. The United States are as much bound by their contracts as are individuals. If they repudiate their obligations it is as much repudiation, with all the wrong and reproach that term implies, as it would be if the repudiator had been a state or a municipality or a citizen. No change can be made in the title created by the grant of the lands, or in the contract for the subsidy bonds, without the consent of the corporation. All this is indisputable.

The contract of the company in respect to the subsidy bonds is to pay both principal and interest when the principal matures, unless the debt is sooner discharged by the application of one-half the compensation for transportation and other services rendered for the government, and the five per cent. of net earnings as specified in the charter. This was decided in *United States v. Union Pacific Railroad Co.*, 91 U. S. 72. The precise point to be determined now is, whether a statute which requires a company in the management of its affairs to set aside a portion of its current income as a sinking-fund to meet this and other mortgage debts when they mature, deprives the company of its property without due process of law, or in any other way improperly interferes with vested rights.

This corporation is a creature of the United States. It is a private corporation created for public purposes, and its property is to a large extent devoted to public uses. It is, therefore, subject to legislative control so far as its business affects the public interests. *Chicago, Burlington & Quincy Railroad Co. v. Iowa*, 94 U. S. 155.

It is unnecessary to decide what power congress would have had over the charter if the right of amendment had not been reserved; for, as we think, that reservation had been made. In the act of 1862, section 18, it was accompanied by an explanatory statement showing that this had been done "the better to accomplish the object of this act, namely, to promote the public interest and welfare by the construction of said railroad and telegraph line, and keeping the same in working order, and to secure to the government at all times (but especially in time of war) the use and benefits of the same for postal, military and other purposes," and by an injunction that it should be used with "due regard for the rights of said companies." In the act of 1864, however, there is nothing except the simple words (section 22) "that congress may at any time alter, amend, and repeal this act." Taking both acts together, and giving the explanatory statement in that of 1862 all the effect it can be entitled to, we are of the opinion that congress not only retains, but has given special notice of its intention to retain, full and complete power to make such alterations and amendments of the charter as come within the just scope of legislative power. That this power has a limit, no one can doubt. All agree that it can not be used to take away property already acquired under the operation of the charter, or to deprive the corporation of the fruits actually reduced to possession of contracts lawfully made; but, as was said by this court, through Mr. Justice Clifford, in *Miller v. The State* (15 Wall. 498), "it may safely be affirmed that the reserved power may be exercised, and to almost any extent, to carry into effect the original purposes of the grant, or to secure the due administration of its affairs, so as to protect the rights of stockholders and of creditors, and for the proper disposition of its assets;" and again, in *Holyoke Company v. Lyman* (15 Wall. 519), "to protect the rights of the public and of the corporators, or to promote the due administration of the affairs of the corporation." Mr. Justice Field, also speaking for the court, was even more explicit when, in *Tomlinson v. Jessup* (15 Wall. 459), he said, "the reservation affects the entire relation between the state and the corporation, and places under legislative control all rights, privileges, and immunities derived by its charter directly from the state;" and again, as late as *Railroad Company v. Maine* (96 U. S. 510), "by the reservation \* \* \* the state retained the power to alter it [the charter] in all particulars constituting the grant to the new company, formed under it, of corporate rights, privileges, and immunities." Mr. Justice Swayne, in *Shields v. Ohio* (95 U. S. 324), says, by way of limitation, "The alterations must be reasonable; they must be made in good faith, and be consistent with the object and scope of the act of incorporation. Sheer oppression and wrong can not be inflicted under

the guise of amendment or alteration." The rules as here laid down are fully sustained by authority. Further citations are unnecessary.

Giving full effect to the principles which have thus been authoritatively stated, we think it safe to say, that whatever rules congress might have prescribed in the original charter for the government of the corporation in the administration of its affairs, it retained the power to establish by amendment. In so doing it can not undo what has already been done, and it can not unmake contracts that have already been made, but it may provide for what shall be done in the future, and may direct what preparation shall be made for the due performance of contracts already entered into. It might originally have prohibited the borrowing of money on mortgage, or it might have said that no bonded debt should be created without ample provision by sinking fund to meet it at maturity. Not having done so at first, it can not now by direct legislation vacate mortgages already made under the powers originally granted, nor release debts already contracted. A prohibition now against contracting debts will not avoid debts already incurred. An amendment making it unlawful to issue bonds payable at a distant day, without at the same time establishing a fund for their ultimate redemption, will not invalidate a bond already out. All such legislation will be confined in its operation to the future.

Legislative control of the administration of the affairs of a corporation may, however, very properly include regulations by which suitable provision will be secured in advance for the payment of existing debts when they fall due. If a state under its reserved power of charter amendment were to provide that no dividends should be paid to stockholders from current earnings until some reasonable amount had been set apart to meet maturing obligations, we think it would not be seriously contended that such legislation was unconstitutional, either because it impaired the obligations of the charter contract or deprived the corporation of its property without due process of law. Take the case of an insurance company dividing its unearned premiums among its stockholders without laying by anything to meet losses, would any one doubt the power of the state under its reserved right of amendment to prohibit such dividends until a suitable fund had been established to meet losses from outstanding risks? Clearly not, we think, and for the obvious reason that while stockholders are entitled to receive all dividends that may legitimately be declared and paid out of the current net income, their claims on the property of the corporation are always subordinate to those of creditors. The property of a corporation constitutes the fund from which its debts are to be paid, and if the officers improperly attempt to divert this fund from its legitimate uses, justice requires that they should in some way be restrained. A court of equity would do this, if called upon in an appropriate manner; and it needs no argument to show that a legislative regulation which requires no more of the corporation than a court would compel it to do without legislation is not unreasonable. \* \* \*

The United States occupy toward this corporation a twofold rela-

tion,—that of sovereign and that of creditor. *United States v. Union Pacific Railroad Co.*, 98 U. S. 569. Their rights as sovereign are not crippled because they are creditors, and their privileges as creditors are not enlarged by the charter because of their sovereignty. They can not, as creditors, demand payment of what is due them before the time limited by the contract. Neither can they, as sovereign or creditors, require the company to pay the other debts it owes before they mature. But out of regard to the rights of the subsequent lienholders and stockholders, it is not only their right, but their duty, as sovereign to see to it that the current stockholders do not, in the administration of the affairs of the corporation, appropriate to their own use that which in equity belongs to others. A legislative regulation which does no more than require them to submit to their just contribution towards the payment of a bonded debt can not in any sense be said to deprive them of their property without due process of law.

The question still remains, whether the particular provision of this statute now under consideration comes within this rule. It establishes a sinking fund for the payment of debts when they mature, but does not pay the debts. The original contracts of loan are not changed. They remain as they were before, and are only to be met at maturity. All that has been done is to make it the duty of the company to lay by a portion of its current net income to meet its debts when they do fall due. In this way the current stockholders are prevented to some extent from depleting the treasury for their own benefit, at the expense of those who are to come after them. This is no more for the benefit of the creditors than it is for the corporation itself. It tends to give permanency to the value of the stock and bonds, and is in the direct interest of a faithful administration of affairs. It simply compels the managers for the time being to do what they ought to do voluntarily. The fund to be created is not so much for the security of the creditors as the ultimate protection of the public and the corporators.

To our minds it is a matter of no consequence that the secretary of the treasury is made the sinking-fund agent and the treasury of the United States the depository, or that the investment is to be made in the public funds of the United States. This does not make the deposit a payment of the debt due the United States. \* \* \*

Not to pursue this branch of the inquiry any further, it is sufficient now to say that we think the legislation complained of may be sustained on the ground that it is a reasonable regulation of the administration of the affairs of the corporation, and promotive of the interests of the public and the corporators. It takes nothing from the corporation or the stockholders which actually belongs to them. It oppresses no one, and inflicts no wrong. It simply gives further assurance of the continued solvency and prosperity of a corporation in which the public are so largely interested, and adds another guaranty to the permanent and lasting value of its vast amount of securities.



The legislation is also warranted under the authority by way of amendment to change or modify the rights, privileges, and immunities granted by the charter. The right of the stockholders to a division of the earnings of the corporation is a privilege derived from the charter. When the charter and its amendments first became laws, and the work on the road was undertaken, it was by no means sure that the enterprise would prove a financial success. No statutory restraint was then put upon the power of declaring dividends. It was not certain that the stock would ever find a place on the list of marketable securities, or that there would be any bonds subsequent in lien to that of the United States which could need legislative or other protection. Hence, all this was left unprovided for in the charter and its amendments as originally granted, and the reservation of the power of amendment inserted so as to enable the government to accommodate its legislation to the requirements of the public and the corporation as they should be developed in the future. Now it is known that the stock of the company has found its way to the markets of the world; that large issues of bonds have been made beyond what was originally contemplated, and that the company has gone on for years dividing its earnings without any regard to its increasing debt, or to the protection of those whose rights may be endangered if this practice is permitted to continue. For this reason congress has interfered, and, under its reserved power, limited the privilege of declaring dividends on current earnings, so as to confine the stockholders to what is left after suitable provision has been made for the protection of creditors and stockholders against the disastrous consequences of a constantly increasing debt. \* \* \*

*Judgment and decree affirmed.*

MR. JUSTICE BRADLEY, dissenting. \* \* \* The contract between the Union and Central Pacific Railroad Companies and the government was an executed contract, and a definite one. It was in effect this: that the government should loan the companies certain moneys, and that the companies should have a certain period of time to repay the amount, the loan resting on the security of the companies' works. Congress, by the law in question, without any change of circumstances, and against the protest of the companies, declares that the money shall be paid at an earlier day, and that the contract shall be changed *pro tanto*. This is the substance and effect of the law. Calling the money paid a sinking-fund makes no substantial difference. The pretense or excuse for the law is that the stipulated security is not good. Congress takes up the question, *ex parte*, discusses and decides it, passes judgment, and proposes to issue execution, and to subject the companies to heavy penalties if they do not comply. That is the plain English of the law. In view of the limitations referred to, has congress the power to do this? In my judgment it has not. The law virtually deprives the companies of their property without due process of law; takes it for public use without compensation; and operates as an exercise by congress of the judicial power of the government.

That it is a plain and flat violation of the contract there can be no reasonable doubt. But it is said that congress is not subject to any inhibition against passing laws impairing the validity of contracts. This is true; and the reason why the inhibition to that effect was imposed upon the states and not upon congress evidently was, that the power to pass bankrupt laws should be exclusively vested in congress, in order that the bankruptcy system might be uniform throughout the United States. When the states exercised the power, they often did it in such a manner as to favor their own citizens at the expense of the citizens of other states and of foreign countries. It was deemed expedient, therefore, to take the power from the states so far as it might involve the impairing the validity of contracts. State bankrupt laws, since the constitution went into effect, have only been sustained when operating prospectively upon contracts, and then only in the absence of a national law. The inhibition referred to undoubtedly had its origin in these considerations. It fully explains the fact that no such inhibition was laid upon the national legislature; and the absence of such an inhibition, therefore, furnishes no ground of argument in favor of the proposition that congress may pass arbitrary and despotic laws with regard to contracts any more than with regard to any other subject-matter of legislation. The limitations already quoted exist in their full force, and apply to that subject as well as to all others. They embody the essential principles of Magna Charta, and are especially binding upon the legislative department of the government. Under the English constitution, notwithstanding the theoretical omnipotence of Parliament, such a law as the one in question would not be tolerated for a moment. The famous denunciation that "it would cut every Englishman to the bone," would be promptly reiterated.

It will not do to say that the violation of the contract by the law in question is not a taking of property. In the first place it is literally a taking of property. It compels the companies to pay over to the government, or its agents, money to which the government is not entitled. That it will be entitled by the contract to a like amount at some future time does not matter. Time is a part of the contract. To coerce a delivery of the money is to coerce without right a delivery of that which is not the property of the government but the property of the companies. It is needless to refer to the importance to the companies of the time which the contract gives. If it be alleged that the security of the government requires this to be done in consequence of waste or dissipation by the companies of the mortgage security, that is a question to be decided by judicial investigation with opportunity of defense. A prejudgment of the question by the legislative department is a usurpation of the judicial power.

But if it were not, as it is, an actual or physical taking of property,—if it were merely the subversion of the contract and the substitution of another contract in its place, it would be a taking of property within the spirit of the constitutional provisions. A contract is property. To destroy it wholly or to destroy it partially is to take it;

and to do this by arbitrary legislative action is to do it without due process of law. \* \* \*

(Continuing, as to the reserved power to alter or amend):

In my judgment, the reservation is to be interpreted as placing the state legislature back on the same platform of power and control over the charter containing it as it would have occupied had the constitutional restriction about contracts never existed; and I think the reservation effects nothing more. It certainly can not be interpreted as reserving a right to violate a contract at will. No legislature ever reserved such a right in any contract. Legislatures often reserve the right to terminate a continuous contract at will; but never to violate a contract, or change its terms without the consent of the other party. The reserved power in question is simply that of legislation,—to alter, amend, or repeal a charter. This is very different from the power to violate, or to alter the terms of a contract at will. A reservation of power to violate a contract, or alter it, or impair its obligation, would be repugnant to the contract itself, and void. A proviso repugnant to the granting part of a deed, or to the enacting part of a statute, is void. Interpreted as a reservation of the right to legislate, the reserved power is sustainable on sound principles; but interpreted as the reservation of a right to violate an executed contract, it is not sustainable.

The question then comes back to the extent of the power to legislate. But that is a restricted power,—restricted by other constitutional provisions, to which reference has already been made. Certainly the legislature can not, in a charter of incorporation, or in any other law, reserve to itself any greater power of legislation than the constitution itself concedes to it. It seems to me clear, therefore, that the power reserved can not authorize a flat abrogation of the contract by congress, because, as before shown, such an abrogation would be a violation of those clauses which inhibit the taking of property without process of law and without compensation. \* \* \*

*Note:* 1885, *Northern Pacific R. v. Traill Co.*, 115 U. S. 600; 1887, *In re Pacific R. Commission*, 32 Fed. Rep. 241, 260; 1895, *United States v. Stanford*, 69 Fed. Rep. 25, 70 Fed. Rep. 346; 1896, *United States v. Stanford*, 161 U. S. 412. See note to section 473, *infra*.

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**Sec. 456. (c) Power of the state legislatures,—no reserve power to repeal.**

See *Trustees of Dartmouth College v. Woodward*, 4 Wheat. (U. S.) 518, *supra*, p. 708.

**Sec. 457. Same.** Extent of doctrine of the Dartmouth College Case.

**PEARSALL v. GREAT NORTHERN RAILWAY COMPANY.<sup>1</sup>**

1896. IN THE SUPREME COURT OF THE UNITED STATES. 161  
U. S. Rep. 646-677.

In 1856 the Minneapolis and St. Cloud Railroad Company was incorporated by the legislature of the territory of Minnesota with authority to construct a railroad on an indicated route, and to connect its road by branches with any other road in the territory, or to become part owner or lessee of any railroad in said territory, and also "to connect with any railroad running in the same direction with this road and where there may be any portion of another road which may be used by this company." By a subsequent act it was, in 1865, authorized "to connect with or adopt as its own any other railroad running in the same general direction with either of its main lines or any branch roads, and which said corporation is authorized to construct;" "to consolidate the whole or any portion of its capital stock with the capital stock or any portion thereof of any other road having the same general direction or location, or to become merged therein by way of substitution;" to consolidate any portion of its road and property with the franchise of any other railroad company or any portion thereof; and to consolidate the whole or any portion of its main line or branches with the rights, powers, franchises, grants and effects of any other railroad. These several rights, privileges and franchises were duly accepted by the railway company, and its road was constructed and put in operation.

In 1874 the state of Minnesota enacted that "no railroad corporation, or the lessees, purchasers or managers of any railroad corporation, shall consolidate the stock, property or franchises of such corporation with, or lease or purchase the works or franchises of, or in any way control any other railroad corporation owning or having under its control a parallel or competing line; nor shall any officer of such railroad corporation act as the officer of any other railroad corporation owning or having the control of a parallel or competing line; and the question whether railroads are parallel or competing lines shall, when demanded by the party complainant, be decided by a jury as in other civil issues;" and in 1881 its legislature enacted that "no railroad corporation shall consolidate with, lease or purchase, or in any way become owner of, or control any other railroad corporation, or any stock, franchise, rights of property thereof, which owns or controls a parallel or competing line." In 1889 the company changed its name to Great Northern Railway Company and extended its road towards the Pacific. The Northern Pacific Railroad being

<sup>1</sup>Statement is taken from the syllabus; arguments and part of opinion omitted.

about to be reorganized, it was proposed that the Great Northern company should guarantee, for the benefit of the holders of the bonds to be issued by the reorganized company, the payment of the principal of, and interest upon such bonds, and as a consideration of such guaranty, and as a compensation for the risk to the stockholders, the reorganized company should transfer to the shareholders of the Northern company, or to a trustee for their use, one-half the capital stock of the reorganized company; and that the Northern Pacific should join with the Great Northern in providing facilities for an interchange of cars and traffic between their respective lines, and should interchange traffic with the Northern company, and operate its trains to that end upon reasonable, fair and lawful terms under joint tariffs or otherwise, the Northern company having the right to bill its traffic, passengers and freight from points on its own line to points on the Northern Pacific not reached by the Great Northern, with the further right to make use of the terminal facilities of the Northern Pacific at points where such facilities would be found to be convenient and economical, jointly with that company. A stockholder of the Great Northern Company filed this bill against it to restrain it from carrying out such agreement.

(The bill was dismissed by the circuit court. Appeal taken.)

MR. JUSTICE BROWN: This case turns upon the question whether the right given by its charter to the Minneapolis and St. Cloud Railroad Company to connect with any railroad running in the same general direction, and, by subsequent amendatory act, to consolidate its capital stock, or its property, road or franchise with those of any other railroad, could be taken away by a subsequent act inhibiting the consolidation, lease or purchase by any railroad of the stock, property or franchise of any parallel or competing line. A different question would have been presented if any such contract had been made and carried into effect, before the act of 1874 was passed, since it might be claimed that the rights of the parties had become vested, within the meaning of section 17 of the original charter of the Minnesota and St. Cloud Railroad, and as such could not be destroyed or impaired by subsequent legislation, without infringing upon that provision of the constitution inhibiting state legislation impairing the obligation of contracts. The case then involves indirectly the meaning of the words "vested rights," when used in the charter of railroads and other similar corporations.

1. [Extent of the doctrine of the Dartmouth College decision.] The whole doctrine of vested rights as applied to the charters of corporations is based upon the Dartmouth College Case, 4 Wheat. 518, in which the broad proposition was laid down that such charters were contracts within the meaning of the constitution, and hence that an act of the state legislature altering a charter in any material respect was unconstitutional and void. The doctrine of this case has been subjected to more or less criticism by the courts and the profession, but has been reaffirmed and applied so often as to have become firmly established as a canon of American jurisprudence. The precise

point decided was this: By the original charter from the Crown, granted in the year 1769, twelve persons, therein named, were incorporated by the name of "The Trustees of Dartmouth College," and there was granted to them and their successors the usual corporate privileges and powers, among which was authority to govern the college, and fill all vacancies which might be created in their own body. By an act of the legislature of New Hampshire, passed in 1816, the charter was amended, the number of trustees increased to twenty-one, the appointment of the additional members vested in the executive of the state, and a board of overseers, consisting of twenty-five persons, created with power to inspect and control the most important acts of the trustees. The president of the senate, the speaker of the house of representatives of New Hampshire, and the governor and the lieutenant-governor of Vermont, for the time being, were to be members *ex officio*, and the board was to be completed by the governor and council of New Hampshire, who were also empowered to fill all vacancies which might occur. A majority of the trustees of the college refused to accept this amended charter and brought suit for the corporate property, which was in possession of a person holding by authority of the acts of the legislature.

The opinion contained an exhaustive discussion of the whole subject of corporate rights and their impairment by state legislation, and probably contributed as much as any he ever delivered to the great reputation of Chief Justice Marshall. The proposed legislation of the state was fundamental in its character. On the part of the Crown it was expressly stipulated that the corporation thus constituted should continue forever; and that the number of trustees should consist of twelve and no more. By the act of the legislature the trustees were increased to twenty-one, the appointment of the additional number given to the executive of the state, and a board of overseers, twenty-one out of twenty-five of whom were also appointed by the executive of the state, was created and invested with power to inspect and control the most important acts of the trustees. "Thus," said Mr. Chief Justice Marshall, "the whole power of governing the college is transferred from trustees, appointed according to the will of the founder, expressed in the charter, to the executive of New Hampshire." If this legislation was valid, Dartmouth College, as it was originally incorporated, ceased to exist, and a new institution of learning was created, which was put completely at the mercy of the state legislature. It was not the case of an amendment in an unimportant particular—the taking away of a non-essential feature of the charter, but a radical and destructive change of the governing body—a transfer of its power to the executive of the state, and virtually a reincorporation upon a wholly different basis.

Subsequent cases have settled the law that, wherever property rights have been acquired by virtue of a corporate charter, such rights, so far as they are necessary to the full and complete enjoyment of the main object of the grant, are contracts, and beyond the reach of destructive legislation. Even before the Dartmouth College



case was decided, it was held by this court that grants of land made by the Crown to colonial churches were irrevocable, and that property purchased by, or devised to them, prior to the adoption of the constitution, could not be diverted to other purposes by the states which succeeded to the sovereign power of the colonies. *Terrett v. Taylor*, 9 Cranch 43; *Town of Pawlet v. Clark*, 9 Cranch 292; *Society for Propagation of the Gospel v. New Haven*, 8 Wheat. 464.

Indeed, the sanctity of charters vesting in grantees the title to lands or other property has been vindicated in a large number of cases. *Davis v. Gray*, 16 Wall. 203; *Fletcher v. Peck*, 6 Cranch 87, 137; *Moore v. Robbins*, 96 U. S. 530; *United States v. Schurz*, 102 U. S. 378; *Noble v. Union River Logging Railroad*, 147 U. S. 165.

This court has had, perhaps, more frequent occasion to assert the inviolability of corporate charters in cases respecting the power of taxation than in any other, and in a long series of decisions has held that a clause imposing certain taxes in lieu of all other taxes, or of all taxes to which the company or stockholders therein would be subject, is impaired by legislation raising the rate of taxation, or imposing taxes other than those specified in the charter. Thus in *State Bank of Ohio v. Knoop*, 16 How. 369, it was held that, where, by a general banking law, it was provided that a certain percentage of dividends should be set off for the use of the state, and should be in lieu of all taxes to which the company or stockholders therein would otherwise be subjected, this was a contract fixing permanently the amount of taxation, and that legislation could not thereafter increase it. In this connection it was said by Mr. Justice McLean: "Every valuable privilege given by the charter, and which conduced to an acceptance of it and an organization under it, is a contract which can not be changed by the legislature where the power to do so is not reserved in the charter. The rate of discount, the duration of the charter, the specific tax agreed to be paid, and other provisions essentially connected with the franchise, and necessary to the business of the bank, can not, without its consent, become a subject for legislative action." To the same effect are *New Jersey v. Wilson*, 7 Cranch 164; *Gordon v. Appeal Tax Court*, 3 How. 133; *Dodge v. Woolsey*, 18 How. 331; *Jefferson Branch Bank v. Skelly*, 1 Black 436; *McGee v. Mathis*, 4 Wall. 143; *Home of the Friendless v. Rouse*, 8 Wall. 430; *Wilmington Railroad v. Reid*, 13 Wall. 264; *Humphrey v. Pegues*, 16 Wall. 244; *Farrington v. Tennessee*, 95 U. S. 679; *New Jersey v. Yard*, 95 U. S. 104; *Asylum v. New Orleans*, 105 U. S. 362. If, however, the charter contain a reservation of an unlimited power to alter, amend or repeal, the legislature may take away an immunity from taxation. *Tomlinson v. Jessup*, 15 Wall. 454.

Within the same principle are grants of an exclusive right to supply gas or water to a municipality, or to occupy its streets for railway purposes. *New Orleans Gas Co. v. Louisiana Light Co.*, 115 U. S. 650; *New Orleans Water Works v. Rivers*, 115 U. S. 674; *Louisville Gas Co. v. Citizens' Gas Co.*, 115 U. S. 683; *St. Tammany*

Water Works v. New Orleans Water Works, 120 U. S. 64; Boston & Lowell Railroad v. Salem & Lowell Railroad, 2 Gray 1.

So, if a company be chartered with power to construct and maintain a turnpike, erect toll-gates and collect tolls, such franchise is protected by the constitution. Turnpike Co. v. Illinois, 96 U. S. 63; Monongahela Navigation Co. v. United States, 148 U. S. 312.

If it be provided in the charter of a bank that the bills and notes of the institution shall be received in payment of taxes or of debts due to the state, such undertaking on the part of the state constitutes a contract between the state and holders of the notes, which the state is not at liberty to break, although notes issued after the repeal of the act are not within the contract, and may be refused. Woodruff v. Trapnall, 10 How. 190; Paup v. Drew, 10 How. 218; Furman v. Nichol, 8 Wall. 44; Keith v. Clark, 97 U. S. 454; Antoni v. Greenhow, 107 U. S. 769; Poindexter v. Greenhow, 114 U. S. 270. And in Planters' Bank v. Sharp, 6 How. 301, where a bank was chartered with the usual powers to receive money on deposit, discount bills of exchange and notes, and to make loans, and in the course of its business the bank discounted and held promissory notes, and the legislature then passed a law declaring that it should not be lawful for any bank to transfer, by indorsement or otherwise, any note, bill receivable or other evidence of debt, it was held that the statute conflicted with the constitution and was void. It was said in this case that "a power to dispose of its notes, as well as other property, may well be regarded as an incident to its business as a bank to discount notes, which are required to be in their terms assignable, as well as an incident to its right of holding them and other property, when no express limitation is imposed upon the power to transfer them."

In each of the above cases, however, the title to property had either become vested in the grantee by operation of law, or the exercise of the power granted was so far necessary to the full enjoyment of the main object of the charter that persons subscribing to the stock might be presumed to take into consideration, and be influenced in their subscriptions, by the fact that the corporation was endowed with those privileges during the continuance of the charter.

2. [Limits of the doctrine of the Dartmouth College decision.] Such limitations, however, upon the power of the legislature must be construed in subservience to the general rule that grants by the state are to be construed strictly against the grantees, and that nothing will be presumed to pass except it be expressed in clear and unambiguous language. As was said by Mr. Justice Swayne in Fertilizing Co. v. Hyde Park, 97 U. S. 659, 666: "The rule of construction in this class of cases is that it shall be most strongly against the corporation. Every reasonable doubt is to be resolved adversely. Nothing is to be taken as conceded but what is given in unmistakable terms or by an implication equally clear. The affirmative must be shown. Silence is negation, and doubt is fatal to the claim. This doctrine is vital to the public welfare. It is axiomatic in the jurisprudence of this court."

Hence, an exclusive right to enjoy a certain franchise is never presumed, and unless the charter contain words of exclusion it is no impairment of the grant to permit another to do the same thing, although the value of the franchise to the first grantee may be wholly destroyed. This principle was laid down at an early day in the case of the Charles River Bridge v. Warren Bridge, 11 Pet. 420, and has been steadily adhered to ever since. Turnpike Company v. The State, 3 Wall. 210; Providence Bank v. Billings, 4 Pet. 514; Pennsylvania Railroad v. Miller, 132 U. S. 75. If, however, there be an exclusive provision as, for instance, in the charter of a bridge company, that it shall not be lawful for any person to erect another bridge within a certain distance of the bridge authorized, this constitutes an inviolable contract. The Binghamton Bridge, 3 Wall. 51. But even in such cases if the second charter be for a similar franchise, but to be exercised in a substantially different manner, the exclusive right conferred by the first charter is held not to be violated; as, for instance, if the first charter be for an ordinary bridge, and the second for a railway viaduct, impossible for man or beast to cross except in railway cars. Bridge Proprietors v. Hoboken Co., 1 Wall. 116. So if the first franchise be for the sole privilege of supplying a city with water from a designated source, it is not impaired by a grant to another party of the privilege to supply it with water from a different source. Stein v. Bienville Water Supply Co., 141 U. S. 67.

Upon a similar principle it was held in Tucker v. Ferguson, 22 Wall. 527, that a tax upon lands owned by a railway company and not used, nor necessary, in working the road and in the exercise of its franchise was not unlawful, though the charter had provided for a certain tax upon the railroad company, and had enacted that such tax should be in lieu of all other taxes to be imposed within the state. See, also, West Wisconsin Railway v. Supervisors, 93 U. S. 595.

Nor does it follow, from the fact that the contract evidenced by the charter can not be impaired, that the power of the legislature over such charter is wholly taken away, since statutes which operate only to regulate the manner in which the franchises are to be exercised, and which do not interfere substantially with the enjoyment of the main object of the grant, are not open to the objection of impairing the contract.

A familiar instance of this class of legislation is that enacted under what is known as the police power. In virtue of this the state may prescribe regulations contributing to the comfort, safety and health of passengers, the protection of the public at highway crossings or elsewhere, the security of owners of adjacent property, by requiring the track to be fenced, and such appliances to be annexed to the engines as shall prevent the communication of fire to neighboring buildings. Cooley Prin. Const. Law, 321. This power, as was said by Mr. Justice Miller in the Slaughter-house Cases, 16 Wall. 36, 62, is and must be, from its very nature, incapable of any very exact definition or limitation. "Upon it depends the security of social order, the life and health of the citizen, the comfort of existence in a thickly

populated community, the enjoyment of private and social life, and the beneficial use of property." The following cases show to what extent and for what purposes this power may be exercised: *Slaughter-house Cases*, 16 Wall. 36; *Fertilizing Company v. Hyde Park*, 97 U. S. 659; *Beer Co. v. Massachusetts*, 97 U. S. 25; *Patterson v. Kentucky*, 97 U. S. 501; *Barbier v. Connolly*, 113 U. S. 27; *Charlotte, Columbia, etc., Railroad v. Gibbes*, 142 U. S. 386; *Lawton v. Steele*, 152 U. S. 133; *Eagle Insurance Co. v. Ohio*, 153 U. S. 446. And so important is this power and so necessary to the public safety and health, that it can not be bargained away by the legislature, and hence it has been held that charters for purposes inconsistent with a due regard for the public health or public morals may be abrogated in the interests of a more-enlightened public opinion. *Stone v. Mississippi*, 101 U. S. 814; *Phalen v. Virginia*, 8 How. 163, 168.

In obedience to the same principle it has always been held that the legislature may repeal laws authorizing municipal subscriptions to railways, though such laws were in existence at the time the railway was chartered, and may be supposed to have influenced the promoters and stockholders of the road in undertaking its construction. And even if there has been a public vote in favor of such subscription, such vote does not itself form a contract with the railway company protected by the constitution, the court holding that until the subscription is actually made the contract is unexecuted. *Aspinwall v. Daviess County*, 22 How. 364; *Wadsworth v. Supervisors*, 102 U. S. 534; *Norton v. Brownsville*, 129 U. S. 479; *Concord v. Portsmouth Savings Bank*, 92 U. S. 625; *Falconer v. Buffalo & Jamestown Railroad*, 69 N. Y. 491; *Covington & Lexington Railroad v. Kenton County Court*, 12 B. Mon. 144; *Wilson v. Polk County*, 112 Mo. 126.

The contract protected by this clause must also be founded upon a good consideration. If it be a mere nude pact, a bare promise to allow a certain thing to be done, it will be construed as a revocable license. Thus, in *Christ Church v. Philadelphia County*, 24 How. 300, the legislature of Pennsylvania enacted that the property of Christ Church Hospital, so long as the same should continue to belong to the same hospital, should be and remain free from taxation. In 1851 they enacted that all property then exempted from taxation, other than that which was in the actual use and occupation of such association, should thereafter be subject to taxation. It was held that the original concession of the legislature exempting the property from taxation was spontaneous, and no service or duty or other remunerative consideration was imposed upon the corporation, and hence that it was in the nature of a privilege or license, which might be revoked at the pleasure of the sovereign.

In *Turnpike Company v. Illinois*, 96 U. S. 63, the original charter of the company gave it the right, in consideration of building a turnpike, to erect toll-gates and exact toll for twenty-five years from the date of the charter. In 1861, when the term of charter had more than half expired, the state gave the company a new and addi-

tional privilege of using a certain bridge and dyke and of erecting a toll-gate thereon. The only consideration required was that the company should keep them in repair. No term was expressed for the enjoyment of the privileges, and no conditions were imposed for resuming or revoking it on the part of the state. It was held that it could not be presumed to have been intended as a perpetual grant, since the company itself had but a limited period of existence, and that a law resuming possession of the bridge and dyke by subjecting them to the control and management of the city of East St. Louis was not a law impairing the obligation of the contract.

In *Philadelphia & Grays Ferry Co.'s Appeal*, 102 Penn. St. 123, it was also held that a supplement to a charter which merely conferred upon the corporation a new right (as an exclusive right to use and occupy certain streets) or enlarged an old one, without imposing any additional burden upon it, was a mere license or promise by the state, and might be revoked at pleasure. "It is without consideration to support it and can not bind a subsequent legislature."

We have epitomized these cases, not because they have any decisive bearing upon the question at issue, but for the purpose of showing the general trend of opinion in this court upon the subject of corporate charters and vested rights.

3. Conceding that there are no authorities directly in point (and the diligence of counsel has failed to cite us to any), let us see how far these principles are applicable to the case under consideration.

(After stating facts substantially as above given.) \* \* \*

We think the proposed arrangement is a plain violation of the acts of the state legislature passed in 1874 and 1881, prohibiting railroad corporations from consolidating with, leasing or purchasing, or in any other way becoming the owner of, or controlling any other railroad corporation, or the stock, franchises or rights of property thereof, having a parallel or competing line.

Under the broad powers conferred by the amended act of 1865, it is probable that this arrangement might be lawfully made; and the question is whether an unexecuted power to make such arrangement is a "vested right" within the meaning of section 17 of the original act. It is possible that, if this arrangement had been actually made and carried into effect, before the acts forbidding the consolidation of parallel or competing lines had been passed, the rights of the parties thereto would have become vested, and could not be impaired by any subsequent act of the legislature. But the real question before us is whether a bare unexecuted power to consolidate with other corporations, a power which, if it exists as claimed by the defendant, would authorize it to absorb by successive and gradual accretions the entire railway system of the country, is not, so long as it remains unexecuted, within the control of and subject to revocation by the legislature, at least so far as it applies to parallel or competing lines.

A vested right is defined by *Fearne*, in his work upon *Contingent Remainders*, as "an immediate fixed right of present or future enjoyment;" and by *Chancellor Kent* as "an immediate right of present



enjoyment, or a present fixed right of future enjoyment," 4 Kent Com. 202. It is said by Mr. Justice Cooley that "rights are vested in contradistinction to being expectant or contingent. They are vested when the right to enjoyment, present or prospective, has become the property of some particular person or persons as a present interest. They are expectant when they depend upon the continued existence of the present condition of things until the happening of some future event. They are contingent when they are only to come into existence on an event or condition which may not happen or be performed until some other event may prevent their vesting." Principles of Const. Law 332.

As applied to railroad corporations it may reasonably be contended that the term extends to all rights of property acquired by executed contracts, as well as to all such rights as are necessary to the full and complete enjoyment of the original grant, or of property legally acquired subsequent to such grant. If, for example, the legislature should authorize the construction of a certain railroad, and by a subsequent act should take away the power to raise funds for the construction of the road in the usual manner by a mortgage, or the power to purchase rolling stock or equipment, such acts might perhaps be treated as so far destructive of the original grant as to render it valueless, although there might in neither case be an express repeal of any of its provisions. *Sala v. New Orleans*, 2 Woods 188.

But where the charter authorizes the company in sweeping terms to do certain things which are unnecessary to the main object of the grant, and not directly and immediately within the contemplation of the parties thereto, the power so conferred, so long as it is unexecuted, is within the control of the legislature and may be treated as a license, and may be revoked, if a possible exercise of such power is found to conflict with the interests of the public. As applicable to the case under consideration, we think it was competent for the legislature to declare that the power it had conferred upon the Minneapolis and St. Cloud Railway Company to consolidate its interest with those of other similar corporations should not be exercised, so far as applicable to parallel and competing lines, inasmuch as it is for the interest of the public that there should be competition between parallel roads. The legislature has the right to assume in this connection that neither road would reduce its tariff to a destructive or unprofitable figure, or to a point where either road would become valueless to its stockholders, and that the object of the act in question is to prevent such a combination between the two as would constitute a monopoly. \* \* \*

We do not deem it necessary to express an opinion in this case whether the legislature could wholly revoke the power it had given to this company to extend its system by the construction or purchase of branch lines or feeders; since the possibility of an extension of the road, even to the Pacific coast, may have had an influence upon persons contemplating the purchase of its stock or securities, so that a right to do this might be said to have become vested. But we think



it was competent for the legislature, out of due regard for the public welfare, to declare that its charter should not be used for the purpose of stifling competition and building up monopolies. In short, we can not recognize a vested right to do a manifest wrong.

*Reversed*, Field and Brewer, JJ., dissenting.

*Note.* In this case there was a reserve power to amend or repeal, but in the subsequent case of 1896, *Louisville & N. R. Co. v. Kentucky*, 161 U. S. 677, it was held that the right to repeal or amend was of no importance, as the same authority could be exercised under the police power, in case of an unexecuted privilege of this kind: compare 1875, *Zimmer v. State*, 30 Ark. 677; *Adams v. Yazoo, etc., Ry. Co.*, 77 Miss. 194, 60 L. R. A. 33.

**Sec. 458. (d) Power of legislature,—under reserve power to repeal.<sup>1</sup>**

**GREENWOOD v. FREIGHT COMPANY.<sup>2</sup>**

1881. IN THE SUPREME COURT OF THE UNITED STATES. 105 U. S. Rep. 13-24.

[Appeal from circuit court. Suit by Greenwood, a stockholder in the Marginal Freight Railway Company, to prevent the Union Freight Railroad Company from taking possession of the tracks and right of way of the Marginal Company. This company was chartered in 1867 to construct a railroad through certain streets in the city of Boston. In 1872 the Union Company was incorporated and directed "to take the tracks or any part thereof of the Marginal Company, subject to laws relating to the taking of land by railroad companies and the compensation to be made therefor;" this act also repealed the charter of the Marginal Company, under the authority of a general law of 1831, reserving the right to repeal, alter or amend all subsequent acts of incorporation. It was complained that the repeal and turning over the tracks to another company were unconstitutional. Decision below in favor of Union Company].

MR. JUSTICE MILLER. \* \* \* These exercises of power in the statute complained of are divisible into two:—

1. The repeal of the charter of the Marginal Company.
2. The authority vested in the Union Company to take its track for the use of the latter company.

It is the argument of counsel, pressed upon us with much vigor, that the two taken together constitute a transfer of the property of the one corporation to the other, and with it all the corporate franchises, rights and powers belonging to the elder corporation.

We are not insensible to the force of the argument as thus stated; and we think it must be conceded that, according to the unvarying

<sup>1</sup> As to difference between revoke, repeal, alter and amend, see 1900, *Wilmington City R. Co. v. Wilmington*, — Del. —, 46 Atl. 12.

<sup>2</sup> Statement abridged. Part of opinion omitted.

decisions of this court, the unconditional repeal of the charter of the Marginal Company is void under the constitution of the United States, as impairing the obligation of the contract made by the acceptance of the charter between the corporators of that company and the state, unless it is made valid by that provision of the general statutes of Massachusetts, called the reservation clause, concerning acts of incorporation; or unless it falls within some enactment covered by that part of its own charter which makes it "subject to all the duties, restrictions and liabilities set forth in the general laws, which now are or may hereafter be in force, relating to street railway corporations, so far as they may be applicable."

The first of these reservations of legislative power over corporations is found in section 41 of chapter 68 of the general statutes of Massachusetts, in the following language: "Every act of incorporation passed after the eleventh day of March, in the year one thousand eight hundred and thirty-one, shall be subject to amendment, alteration or repeal, at the pleasure of the legislature."

It would be difficult to supply language more comprehensive or expressive than this.

Such an act may be amended; that is, it may be changed by additions to its terms or by qualifications of the same. It may be altered by the same power, and it may be repealed. What is it may be repealed? It is the act of incorporation. It is this organic law on which the corporate existence of the company depends which may be repealed, so that it shall cease to be a law; or the legislature may adopt the milder course of amending the law in matters which need amendment, or altering it when it needs substantial change. All this may be done at the pleasure of the legislature. That body need give no reason for its action in the matter. The validity of such action does not depend on the necessity for it, or on the soundness of the reasons which prompted it. This expression, "the pleasure of the legislature," is significant, and is not found in many of the similar statutes in other States.

This statute having been the settled law of Massachusetts, and representing her policy on an important subject for nearly fifty years before the incorporation of the Marginal Company, we can not doubt the authority of the legislature of Massachusetts to repeal that charter. Nor is this seriously questioned by counsel for appellant; and it may, therefore, be assumed that if the repealing clause of the act of May 6, 1872, stood alone, its validity must be conceded. *Crease v. Babcock*, 23 Pick. (Mass.) 334; *Erie & N. E. Railroad Co. v. Casey*, 26 Pa. St. 287; *Pennsylvania College Cases*, 13 Wall. 190; 2 Kent Com. 306.

It is argued, however, that the act is to be examined as a whole, and that as the earlier sections of the statute bestow upon the Union Company the right to seize the track and other property of the Marginal Company, this repealing clause is inserted merely to aid in the general purpose of transferring a valuable property and its appurtenant franchise from one corporation to another.

Whether this is sufficient to invalidate that branch or feature of the statute may depend somewhat upon the effect of the repealing clause upon the rights of the Marginal Company as well as upon other matters; but we do not doubt the validity of the repealing clause of that act, whatever may have been the reasons which influenced the legislature to enact it, for the exercise of this power is by express terms declared to be at the pleasure of the legislature. \* \* \*

What is the effect of the repeal of the charter of a corporation like this?

One obvious effect of the repeal of a statute is that it no longer exists. Its life is at an end. Whatever force the law may give to transactions into which the corporation entered and which were authorized by the charter while in force, it can originate no new transactions dependent on the power conferred by the charter. If the corporation be a bank, with power to lend money and to issue circulating notes, it can make no new loan nor issue any new notes designed to circulate as money.

If the essence of the grant of the charter be to operate a railroad, and to use the streets of the city for that purpose, it can no longer so use the streets of the city, and no longer exercise the franchise of running a railroad in the city. In short, whatever power is dependent solely upon the grant of the charter, and which could not be exercised by unincorporated private persons under the general laws of the state, is abrogated by the repeal of the law which granted these special rights.

Personal and real property acquired by the corporation during its lawful existence, rights of contract, or choses in action so acquired, and which do not in their nature depend upon the general powers conferred by the charter, are not destroyed by such a repeal; and the courts may, if the legislature does not provide some special remedy, enforce such rights by the means within their power. The rights of the shareholders of such a corporation, to their interest in its property, are not annihilated by such a repeal, and there must remain in the courts the power to protect those rights. \* \* \*

As early as 1806, in the case of *Wales v. Stetson* (2 Mass. 143), the supreme court of that state made the declaration "that the rights legally vested in all corporations can not be controlled or destroyed by any subsequent statute, unless a power for that purpose be reserved to the legislature in the act of incorporation." \* \* \*

Mr. Justice Story, in his concurring opinion in the *Dartmouth College* case, suggested that when the legislature was enacting a charter for a corporation, a provision in the statute reserving to the legislature the right to amend or repeal it must be held to be a part of the contract itself, and the subsequent exercise of the right would be in accordance with the contract, and could not, therefore, impair its obligation. And he cites with approval the observations we have already quoted from the case of *Wales v. Stetson*, 2 Mass. 143.

It would seem that the states were not slow to avail themselves of this suggestion, for while we have not time to examine their legisla-

tion for the result, we have in one of the cases cited to us as to the effect of a repeal (*McLaren v. Pennington*, 1 Paige (N. Y.) 102), in which the legislature of New Jersey, when chartering a bank with a capital of \$400,000 in 1824, declared by its seventeenth section that it should be lawful for the legislature at any time to alter, amend, and repeal the same. And Kent (2 Com. 307), speaking of what is proper in such a clause, cites as an example a charter by the New York legislature, of the date of February 25, 1822. How long the legislature of Massachusetts continued to rely on a special reservation of this power in each charter as it was granted it is unnecessary to inquire, for in 1831 it enacted as a law of general application, that all charters of corporations thereafter granted should be subject to amendment, alteration, and repeal at the pleasure of the legislature, and such has been the law ever since.

This history of the reservation clause in acts of incorporation supports our proposition, that whatever right, franchise, or power in the corporation depends for its existence upon the granting clauses of the charter, is lost by its repeal.

This view is sustained by the decisions of this court and of other courts on the same question. *Pennsylvania College Cases*, *supra*; *Tomlinson v. Jessup*, 15 Wall. 454; *Railroad Company v. Maine*, 96 U. S. 499; *Sinking-Fund Cases*, 93 U. S. 700; *Railroad Company v. Georgia*, 98 U. S. 359; *McLaren v. Pennington*, *supra*; *Erie & N. E. Railroad v. Casey*, *supra*; *Miners' Bank v. United States*, 1 Greene (Iowa) 553; 2 Kent Com. 306, 307.

It results from this view of the subject that whatever right remained in the Marginal Company to its rolling-stock, its horses, its harness, its stables, the debts due to it, and the funds on hand, if any, it no longer had the right to run its cars through the streets, or any of the streets, of Boston. It no longer had the right to cumber these streets with a railroad track which it could not use, for these belonged by law to no person of right, and were vested in defendants only by virtue of the repealed charter.

It was, therefore, in the power of the Massachusetts legislature to grant to another corporation, as it did, the authority to operate a street railroad through the same streets and over the same ground previously occupied by the Marginal Company. Whether this action was oppressive or unjust in view of the public good, or whether the legislature was governed by sufficient reason in thus repealing the charter of one company and in chartering another at the same time to perform as part of its functions the duties required of the first, is not, as we have seen, a judicial question in this case. It may well be supposed, if answer were required to the complainant's bill, that it was made to appear that the Marginal Company had shown its incapacity to fulfill the objects for which it was created, and that another corporation, embracing larger area, connecting with more freight depots and wharves, and with more capital, could better serve the public in the matter for which both franchises were given.

That in creating the later corporation, whose object was to fulfill a public use, it could authorize it to take such property of other corporations as might be necessary to that use, as well as that of individuals, can hardly admit of question. Section 4 of the act gives this power to the Union Company with reference to the tracks of all street railroads in the city, and provides that in the event of an inability to agree with the owners of these tracks as to compensation, that shall be determined in accordance with the provisions of general laws previously enacted on that subject. To this there can be no valid legal objection. The property of corporations, even including their franchises, when that is necessary, may be taken for public use under the power of eminent domain, on making due compensation. *West River Bridge Co. v. Dix*, 6 How. 507; *Central Bridge Corporation v. City of Lowell*, 4 Gray (Mass.) 474; *Boston Water-Power Co. v. Boston & Worcester Railroad Corporation*, 23 Pick. (Mass.) 360; *Richmond, etc., Railroad Co. v. Louisa Railroad Co.*, 13 How. 71. \* \* \*

*Affirmed.*

See 1902, *Northern Central R. R. Co. v. Maryland*, 187 U. S. 258.

**Sec. 459. (c)** Effect of repeal upon vested rights.

THE PEOPLE OF THE STATE OF NEW YORK v. JOHN O'BRIEN,  
RECEIVER.<sup>1</sup>

1888. IN THE COURT OF APPEALS OF NEW YORK. 111 N. Y.  
Rep. 1-66, s. c. 45 Hun 519; 7 Am. St. 684.

[The Broadway Surface Railroad Company was a corporation organized under chapter 252 of the laws of 1884, the general act providing for the construction, maintenance and operation of street surface railroads in cities, towns and villages. It obtained the consent of the common council of New York City to lay its tracks, etc., in Broadway in that city, and an order of the general term confirming the report of commissioners, who had recommended the construction of the road through that street, and had complied with all the conditions attached to the said consents. It constructed and operated its road through Broadway and issued bonds, secured by mortgages, covering its road and franchises. It also entered into traffic contracts with other surface railroad companies, granting them permission to connect with and use its tracks upon considerations and subject to conditions specified in such contracts. Thereafter, and while it was so operating its road, chapter 268 of the laws of 1886, was passed by the legislature of the state of New York, by which it was declared "that the corporation called the Broadway Surface Railroad Company, and purporting to have been organized as a corporation \* \* \* for the purpose of constructing, maintaining and operating a surface

<sup>1</sup> Statement taken from 45 Hun 523. Arguments and part of opinion omitted.

railroad on Broadway in the city of New York, between the Battery and Fifteenth street, be and the same is hereby annulled and dissolved and its charter is hereby repealed." Chapter 271 of the same year was passed, providing for the sale of the franchises of corporations which should be dissolved by the legislature, and chapter 310, of the same year, contained provisions for the winding up of such corporations. Under this latter act, John O'Brien was appointed the receiver of the company upon the application of the attorney-general, on the reading of the summons and complaint and a verified copy of the act annulling and dissolving the company without notice to or hearing any one on behalf of the company].

RUGER, CHIEF JUSTICE: \* \* \* [After holding that the rights, privileges and franchises conferred upon the Surface Company (though it was to exist for only 1,000 years), by the consent of the city council, were in the nature of estates in fee, and by the policy of the statutes of the state, were such interests as were independent of the life of the original corporation, and were transferable by judicial proceedings or otherwise,—in short were property in the highest sense, proceeds]:

These rights of property having been acquired and created under the express sanction and authority of the state, it remains to inquire whether they were defeasible and subject to be taken away through the exercise of any power reserved by the state to alter, amend and repeal laws or charters.

The reservations applying to this case are claimed to be as follows: 1st. Section 1, article 8, title, "Corporations, How Created" (constitution of 1846), providing that "all general laws and special acts passed pursuant to this section may be altered from time to time or repealed." 2d. Section 8, title 3, chapter 18 of the Revised Statutes (7th ed.), providing that "the charter of every corporation that shall be granted by the legislature, shall be subject to alteration, suspension and repeal in the discretion of the legislature. 3d. Section 48, chapter 140, laws of 1850, providing that "the legislature may at any time annul or dissolve any incorporation formed under this act, *but such dissolution shall not take away or impair any remedy given against any such corporation, its stockholders, or officers for any liability which shall have been previously incurred.*" And 4th. Chapter 282, laws of 1884, under which this corporation was organized, giving it all the powers and privileges granted, and subject to all of the liabilities imposed by chapter 140, laws of 1850, and the several acts amendatory thereof, and further providing that "the legislature may at any time alter, amend or repeal this act." (Section 19.)

The constitution of 1846 for the first time introduced restrictions upon the power of legislatures to grant special charters and required that provisions for corporations, save in exceptional cases, should thereafter be made by general laws. The obvious intent of the constitutional reservation was to remove any doubt as to the power of the legislature to amend or repeal the laws, whether general or special, authorized by that instrument for the formation of corporations, and



seemed to leave the provisions of the revised statutes, in relation to reserved power over charters, in full force and effect.

It will be observed that the constitution and the act of 1884 provides specially for the amendment and repeal of statutes alone, but the revised statutes and the act of 1850 are addressed specially to the subject of the annulment and repeal of charters created under such statutes.

It seems to us that these provisions relate to different subjects, viz. : The repeal of laws and the annulment of charters formed under such laws, and that the power to do one does not naturally or properly include the power to do the other. (Albany Northern R. R. Co. v. Brownell, 24 N. Y. 345.)

Certainly the repeal of a law authorizing corporations would not destroy organizations formed under it, nor would the annulment of a charter affect the law under which it was created. Neither does it seem reasonable to suppose, while taking away the power of the legislature to create corporate bodies, the constitution intended to confer power to destroy them, thus enabling them to accomplish indirectly that which they were precluded from doing directly. It must be assumed that the framers of the constitution, as well as the legislature, used the language employed by them intelligently and according to its common and customary signification, and when they spoke of the annulment and repeal of acts and laws alone, did not intend to embrace charters as well. These two subjects have frequently been the occasion of legislative action, and since the restrictions upon the powers of the legislature to grant special charters there is no reason to suppose that they did not use the language employed in its literal sense, and especially so when both subjects were immediately within the contemplation of the lawmakers.

In considering this question; the provisions of the Revised Statutes may be laid out of view, for if they contain any broader power than the act of 1850, they must be deemed to have been repealed by the provisions of the latter act, as inconsistent therewith. The reservations, therefore, which apply to this case are contained in the acts of 1850 and 1884, which constitute a part of the railroad charter.

These acts should be read and construed together, and, as thus considered, provide that the legislature may at any time alter, amend and repeal these acts, and may also annul and dissolve charters formed thereunder, but such dissolution shall not take away or impair any remedy against such corporation, its officers and trustees, for any liability previously incurred. The contract proved between the corporation and the state was intended, in respect to a repeal of the charter, to survive the dissolution of the corporation, and to determine the rights of parties interested in the property, in the event of dissolution. By virtue of this contract the corporation secured rights subject to be taken away under certain restrictions, and protected itself from any consequences following a repeal of its charter, except those expressly agreed upon.

But even if it be conceded that the constitutional provisions place

the right to repeal charters, as well as laws, beyond the power of legislatures to waive or destroy, the question still remains as to the effect of such a repeal upon the franchises of the corporation, whether it contemplates anything more than the extinction of the corporate life, and consequent disability to continue business, and exercise corporate functions after that time, or has a wider scope and effect.

It may be assumed in this discussion that the authority of the legislature to repeal a charter, if it has expressed its intention to reserve such power in its grant, constitutes a valid reservation. Parties to a contract may lawfully provide for its termination at the election of either party, and it may, therefore, be conceded that the state had authority to repeal this charter, provided no rights of property were thereby invaded or destroyed. In speaking of the franchises of a corporation we shall assume that none are assignable except by the special authority of the legislature. We must also be understood as referring only to such franchises as are usually authorized to be transferred by statute, viz.: those requiring for their enjoyment the use of corporeal property, such as railroad, canal, telegraph, gas, water, bridge and similar companies, and not to those which are in their nature purely incorporeal and inalienable, such as the right of corporate life, the exercise of banking, trading and insurance powers, and similar privileges. The franchises last referred to being personal in character and dependent upon the continued existence of the donee for their lawful exercise, necessarily expire with the extinction of corporate life, unless special provision is otherwise made. (*People v. B., F. & C. I. R. Co.*, 89 N. Y. 75, 84; *People v. Metz*, 50 N. Y. 61.)

In the former class it has been held that at common law real estate acquired for the use of a canal company could not be sold on execution against the corporation separate from its franchise, so as to destroy or impair the value of such franchise. (*Gue v. Tide Water Canal Co.*, 24 How. (U. S.) 257), and by parity of reasoning it must follow that the tracks of a railroad company, and the franchise of maintaining and operating its road in a public street, are equally inseparable, in the absence of express legislative authority providing for their severance.

The statute of our state authorizing the sale of the franchise and property of a railroad company on execution, seems to recognize the indissolubility of the connection between the corporeal property, and its incorporeal right of enjoyment.

It is also to be observed that in none of the provisions for repeal in this state is there anything contained, which purports to confer power to take away or destroy property or annul contracts, and the contention that the property of a dissolved corporation is forfeited, rests wholly upon what is claimed to be the necessary consequence of the extinction of corporate life. We do not think the dissolution of a corporation works any such effect. It would not naturally seem to have any other operation upon its contracts or property rights than the death of a natural person upon his. (*Mumma v. Potomac Co.*, 8 Pet. 281, 285.)

The power to repeal the charter of a corporation can not, upon any legal principle, include the power to repeal what is in its nature irrevocable, or to undo what has been lawfully done under power lawfully conferred. (*Butler v. Palmer*, 1 Hill, 324, 335.)

The authorities seem to be uniform to the effect that a reservation of the right to repeal enables a legislature to effect a destruction of the corporate life, and disable it from continuing its corporate business (*People, ex rel., Kimball v. B. & A. R. Co.*, 70 N. Y. 569; *Philips v. Wickham*, 1 Paige 590), and a reservation of the right to alter and amend confers power to pass all needful laws for the regulation and control of the domestic affairs of a corporation, freed from the restrictions imposed by the federal constitution upon legislation impairing the obligation of contracts. (*Munn v. Illinois*, 94 U. S. 113, 123.)

We think no well-considered case has gone further than this, while in many cases such power has been expressly held to be limited to the effect stated. In the language of Chief Justice Marshall in *Fletcher v. Peck* (6 Cranch 87, 135): "If an act be done under a law, a succeeding legislature can not undo it. The past can not be recalled by the most absolute power. Conveyances have been made; those conveyances have vested legal estates, and if those estates may be seized by the sovereign authority, still that they originally vested is a fact, and can not cease to be a fact. When, then, a law is in the nature of a contract, when absolute rights have vested under that contract, a repeal of the law can not divest those rights."

It would seem to be quite obvious that a power existing in the legislature by virtue of a reservation only, could not be made the foundation of an authority to do that which is expressly inhibited by the constitution, or afford the basis of a claim to increase jurisdiction over the lives, liberty or property of citizens beyond the scope of express constitutional power.

Since the decision of the celebrated *Trustees Dartmouth College v. Woodward* (4 Wheat. 518), the doctrine that a grant of corporate powers by the sovereign, to an association of individuals, for public use constitutes a contract, within the meaning of the federal constitution prohibiting state legislatures from passing laws impairing its obligations has, although sometimes criticised, been uniformly acquiesced in by the courts of the several states as the law of the land and may be regarded as too firmly established to admit of question or dispute. (*People v. Sturtevant*, 9 N. Y. 263; *Milbau v. Sharp*, 27 N. Y. 611; *Brooklyn Cent. R. Co. v. Brooklyn City R. Co.*, 32 Barb. 364.) The intimation by Judge Story, in that case, that the rule might be otherwise if the legislature should reserve the power of amending or repealing it led to the adoption by the legislature of the various states of the practice of incorporating such reservations in acts of incorporation. Whatever may be the effect of such reservations it is immaterial whether they are embraced in the act of incorporation or in general statutes or provisions of the constitution. In either case they operate upon the contract according to the language of the reservation.

(Morawetz on Corp. 464.) It is manifest, therefore, that in the absence of such reserved power legislatures have no authority to violate, destroy or impair chartered rights and privileges, or power over corporations, except such as they possess by virtue of their legislative authority over persons and property generally. It is obvious that this reserved power does not, in any sense, constitute a condition of the grant, and can not have effect as such, but is simply a power to put an end to the contract with such effect upon the rights of the parties thereto as the law ascribes to it. (Sinking-Fund Cases, 99 U. S. 700, 748; Tomlinson v. Jessup, 15 Wall. 454, 457.) \* \* \*

(Quoting from opinions of Waite, Ch. J., and Bradley, J., see *supra*, p. 1405.)

In *People v. National Trust Company* (82 N. Y. 283, 287), the question was raised that a dissolved corporation was discharged from the obligation to pay rent accruing upon a lease subsequent to its dissolution. Judge Rapallo said: "This claim is not founded upon the allegation of any payment, release or surrender, or anything affecting the merits of the claim, but upon the sole ground that by the dissolution of the corporation the lease was terminated and the covenant to pay rent ceased to be obligatory. We do not regard the dissolution as having any such effect. Under the statutes of this state, on the dissolution of a corporation, its assets become a trust fund for the payment of its debts, and these include debts to mature as well as accrued indebtedness, and all engagements entered into by the corporation which have not been fully satisfied or canceled."

In *Commonwealth v. Essex Company* (13 Gray 239), Justice Shaw said: "When, under power in a charter, rights have been acquired and become vested, no amendment or alteration of the charter can take away the property or rights which have become vested under a legitimate exercise of the powers granted." (*Albany R. Co. v. Brownell*, 24 N. Y. 345.)

The case of *City of Detroit v. Detroit and F. Plankroad Company* (43 Mich. 140), is not only in point, but entitled to high consideration on account of the distinction as a constitutional lawyer of the learned judge who wrote the opinion of the court. The question was whether the legislature had power to compel the defendant to remove its toll-gates from within the city limits after they had been lawfully placed there under the provisions of its charter. Judge Cobley says: "It can not be necessary at this day to enter upon a discussion in denial of the right of the government to take from either individuals or corporations any property which they may rightfully have acquired. In the most arbitrary times such an act was recognized as pure tyranny, and it has been forbidden in England ever since Magna Charta, and in this country always. It is immaterial in what way the property was lawfully acquired, whether by labor in the ordinary avocations of life, by gift, or descent, or by making a profitable use of a franchise granted by the state, it is enough that it has become private property, and it is thus protected by the 'law of the land.'"

And, finally, upon this branch of our subject, we are unable to see

why section 48 of the law of 1850 does not express the rule by which the question under discussion must be determined. That section is expressly made a part of the contract between the state and corporations organized thereunder, and specially provides for the effect which an exercise of the reserved power of repeal by the state shall have upon the franchises of the company. It shall not impair any remedy existing against the corporation, its directors or officers upon a liability previously incurred. This was the contract under which the dissolved corporation issued its stock, mortgaged its franchises, entered into traffic engagements and contracted debts. Creditors, contractors and stockholders had a right to rely upon the promise of the state, that the annulment of the corporate charter should not affect the remedies existing in their favor against the corporation, and this promise is a contract protected by the provisions of the federal constitution.

In the absence of any constitutional provisions prescribing the effect of such repeal, it was competent for the legislature to declare what that should be, and for the state to contract with reference to such a declaration. The right to repeal, as provided by the constitution, is fully recognized by the act of 1850, and the effect of the exercise of the power upon the rights of parties affected thereby is clearly defined.

We are, therefore, of opinion that the statute not only prescribes the rule, creates the contract and regulates the rights of the parties upon the exercise by the state of the power of repeal, but it also correctly formulates the principle of law applicable to the situation. \* \* \*

(Commenting upon *Greenwood v. Freight Co.*, 105 U. S. 13, *supra*, p. 1422; *People v. Globe M. L. I. Co.*, 91 N. Y. 174; *Erie, etc., R. R. v. Casey*, 26 Pa. St. 287, 301, *infra*, p. 1435.)

We are thus brought to the question of the right of succession to the property of a dissolved corporation in the absence of any provision in the act of dissolution providing for such an event.

Sections 9 and 10, title 3, chapter 18, part 1, Revised Statutes (pp. 132, 153, 7th ed.), seem to furnish a conclusive solution to the inquiry. They read as follows: "Section 9. Upon the dissolution of any corporation created or to be created, and unless other persons shall be appointed by the legislature, or by some court of competent authority, the directors or managers of the affairs of such corporation *at the time of its dissolution*, by whatever name they may be known in law, shall be the trustees of the creditors and stockholders of the corporation dissolved, and shall have full power to settle the affairs of the corporation, collect and pay the outstanding debts, and divide among the stockholders the moneys and other property that shall remain after the payment of debts and other necessary expenses." "Section 10. The persons so constituted trustees shall have authority to sue for and recover the debts and property of the dissolved corporation \* \* \* and shall be jointly and severally responsible to the creditors and stockholders of such corporation to the extent of its property and effects that shall come into their hands."

From these sections it would seem that upon the dissolution of this corporation, its remaining trustees became vested with the title of its



property, and responsible to its creditors and stockholders for the value thereof. By operation of law a vested right of action accrued to all creditors and stockholders immediately on the dissolution against such trustees for the value of all property, which did or might by the exercise of reasonable diligence come into their hands. This was a liability which after it once attached was beyond the constitutional power of the legislature to release or discharge. (*Dash v. Vankleeck*, 7 Johns. 477.)

The evidence is undisputed that upon the dissolution, declared by the legislature, the trustees took possession of the railroad property and surrendered its operation to the mortgagees of such railroad. This, in the absence of any objection on the part of creditors or stockholders, they had undoubted authority to do, and the possession of such mortgagees thereafter was the possession of such trustees. They undoubtedly became liable for the value of such property to creditors and stockholders by virtue of such possession, and their authority to administer the assets of the corporation for the purpose of discharging such liability became fixed by the law existing at the time the liability was incurred. The cases in this state fully support these propositions. As was said by the chancellor in *Kane v. Bloodgood* (7 Johns. Ch. 90, 128): "The reasonable construction of the act is that the trustees succeeded to all the rights and privileges of directors and to the same means of defense."

In *McLaren v. Pennington* (1 Paige 102), it was held, as stated in the head note, that "where an act of incorporation is repealed, all the property and rights of the corporation become vested in the directors then in office, or in such persons as by law have the management of the business of the corporation, in trust for the stockholders and creditors, unless the repealing law provides for the appointment of other persons than the officers of the corporation as trustees."

In *Heath v. Barmore* (50 N. Y. 305), Judge Rapallo said: "Under the provisions of 1 Revised Laws 248, and 1 Revised Statutes 600, sections 9 and 10, upon the dissolution of a corporation, the directors or managers at that time become trustees of its property (unless some other custodian is appointed) for the purpose of paying the debts of the corporation and dividing its property among its stockholders, and these provisions apply as well to the real estate as to the personal property of corporations. Consequently, where lands are conveyed absolutely to a corporation having stockholders, no reversion or possibility of a reverter remains in the grantor."

Allen, J., in *Central City Savings Bank v. Walker* (66 N. Y. 428), speaking of the ownership of property and the property rights of a corporation, said: "During the life of the corporation the body corporate was the legal owner, and upon the expiration of the charter the legal title vested in the trustees in office, at the time, in trust, for the creditors and stockholders."

There can be no valid distinction between property held in trust and that owned by individuals in respect to the protection afforded to it by the constitution. The reason for its protection is equally strong in



either case, and the inviolability of the title is in both cases beyond the reach of legislative action. (Trustees Dartmouth College v. Woodward, *supra*.)

It then remains for us to consider the validity of the provisions of chapters 271 and 310 of the laws of 1886. We are fully impressed with the importance of this question, and the well-settled principles of construction which require every statute to be so construed as to uphold its constitutionality, if that may be done by a fair and reasonable interpretation of its language.

Another rule, equally well settled, precludes courts from inquiring into the motives of legislatures in making laws, and to consider them simply with reference to their legal effect upon the rights of persons subjected to their operation.

If, however, upon such examination it is found that constitutional rights will be invaded by the operation of the statute, it is the duty of courts to protect them by declaring the invalidity of the statute.

Upon such examination we are of the opinion that chapter 271 of the laws of 1886 is unconstitutional and void. Its provisions show a naked and undisguised attempt to take away from the Broadway Surface Company, and its stockholders and creditors, its property and bestow the benefit thereof upon the municipality of New York. The act attempts to preserve the validity of the consents held by the corporation, notwithstanding its dissolution, and directs their sale and transfer to the purchaser, and the payment of the purchase-price to the city. \* \* \*

The main argument presented to maintain the constitutionality of this act, is the assertion that these consents do not constitute property within the usual signification of that term. We have considered that question and do not agree with the claim. In view of the fact that the statute expressly contemplates their sale, transfer and acquisition by a purchaser, it would seem unnecessary to go further to prove the fallacy of such a contention.

These remarks apply with equal force to chapter 310. \* \* \*

As we have seen, the property of this corporation vested in the persons who were its directors at the time of its dissolution. They took it as trustees for stockholders and creditors, and were not made parties to the action in which the receiver was appointed. No legislation can authorize the appointment of a receiver of the property of A. in an action against C., without violating the provisions of the constitution in relation to the taking of property without due process of law. That the legislature might amend the provisions of the revised statutes in relation to the devolution of property of dissolved corporations is indisputable, and if it had done so in the act of dissolution, or previously, it would undoubtedly have prevented the vesting of the property in trustees; but this it did not do, and it had no authority, by mere force of legislative enactment, to take vested property from one individual or trustee and give it to another. (McLaren v. Pennington, *supra*; Trustees Dartmouth College v. Woodward, *supra*.)

*Complaint dismissed.*

ANDREWS and EARL, JJ., concur in the result upon these grounds: (1) The annulling act is constitutional and valid, and its effect was only to take the life of the corporation. (2) All the property of the corporation, including its street franchises and its mortgages and valid contracts, including what are called the traffic contracts with other railway companies, survived. (3) The act chapter 271 is unconstitutional. (4) That act and the act chapter 310 are parts of the same scheme adopted by the legislature for the purpose of winding up the affairs of the corporation and disposing of and distributing its property. The main features of the latter act are unconstitutional and void, and thus so much of the legislative scheme has failed that there is not enough left to save the whole act from condemnation. (5) As the latter act is thus wholly void, and this action is founded and depends solely upon it, there is no warrant for its maintenance; and, therefore, the judgment should be reversed and complaint dismissed.

All concur.

Judgment accordingly.

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Sec. 460. Same.

ERIE AND NORTH-EAST RAILROAD v. CASEY.<sup>1</sup>

1856. IN THE SUPREME COURT OF PENNSYLVANIA. 26 Pa. St. Rep. 287-326.

[Bill by the railroad company to enjoin Casey from taking possession of its road, under an act of 1855 repealing and annulling the charter, and authorizing the governor of the state to appoint a person to take charge and custody of the railroad. The company was chartered in 1842, with power to build a railroad, which was duly constructed and in operation, nearly \$750,000 having been expended thereon; that because of an authorized change of gauge in the tracks, the city of Erie had revoked its license to use the streets thereof, and after an injunction it had extended its line to the borough of Erie at an additional expense of \$50,000. The charter provided that the use of streets should not be obstructed, and also "if the said company misuse or abuse any of the privileges hereby granted, the legislature may resume the rights and privileges granted to said company."]

BLACK, J. The Erie and North-East Railroad Company was incorporated in 1842. The charter was repealed at the last session of the legislature, and the governor was authorized to appoint some suitable person to take charge of the road which the company had built, and keep it in good running order and repair, for the use of the public. The defendant was appointed under this provision of the repealing law, and he avows his intention to take possession of the road accordingly, unless prevented by the injunction of this court. To ob-

<sup>1</sup> Statement abridged. Arguments, part of opinion of Black, J., concurring opinion of Lowrie, J., and dissenting opinion of Lewis, C. J., and Woodward, J., omitted.

tain such an injunction is the object of this bill. If the company be threatened with an *illegal* injury, we may protect it in this form of proceeding. If the defendant be justified by *law*, the complaint must be dismissed.

What the defendant means to do is to execute the plain mandate of the supreme law-making power of the state; to carry into effect an act of assembly, passed in regular form. This act, if it be law at all, is paramount to all other law on the subject, and must be obeyed. If, however, the legislature had no *power* to pass it, then it is wholly void, and we must regard it as if the place it occupies on the statute book were a blank.

The right of the judiciary to declare a statute void, and to arrest its execution is one which, in the opinion of all courts, is coupled with responsibilities so grave that it is never to be exercised except in very clear cases; one department of the government is bound to presume that another has acted rightly. The party who wishes us to pronounce a law unconstitutional takes upon himself the burden of proving, beyond all doubt, that it is so.

It is also very well settled that no statute is unconstitutional merely because it is wrong in policy or principle. It is not enough to prove that it is contrary to a sound public morality or injurious to private rights. Inconsistency with rules of law or principles of equity will not make it void. Nothing will have that effect but a *direct* collision between its provisions and those of the federal or state constitution. For this proposition I have no authority or reasons to offer beyond what are already on record in the case of *Sharpless v. The City of Philadelphia*, 9 Harris 147.

The plaintiff's counsel assert that the act of 1855, under which the defendant proposes to take the railroad into his possession, impairs the obligation of a contract. The constitution of the United States (Art. I, section 10), and that of Pennsylvania (Art. IX, section 10), forbid the making of any law impairing the obligation of contracts.

An act granting corporate privileges to a body of men is, when accepted, a contract between the state and the corporators. It is not worth while now to try whether this doctrine will stand the test of original principles. It is sustained by everything that we are bound to regard as authority by the decisions of all the courts in the country, by the opinion of the legal profession and by the general acquiescence of the people. It is not denied by the defendant or his counsel, or by anybody else who has attempted to sustain the action of the legislature in this case. Being a contract, it can not be rescinded by the act of one party without the consent of the other. A grant of corporate privileges for a specified period can not be resumed by the state within such period. If the charter be without limitations as to time it is forever irrevocable.

It does not follow from this that corporations are beyond the reach of public control. When the privileges they enjoy are fraudulently abused, the courts may pronounce them forfeited. In some cases, also, the legislature, when granting the franchises, reserves to itself the right to revoke them. When the charter contains such a stipula-

tion, it is as much a part of the contract as anything else that is in it. The legislative repeal of such a charter bears no resemblance to the judgment of a court against a corporation on a *quo warranto*. They proceed upon principles as different as the functions of the legislature are different from those of the judiciary. If the power to repeal be reserved, its exercise is merely carrying out the contract according to its terms; and the state is using her own rights; not forfeiting those of the company.

The power to repeal is sometimes reserved absolutely, so that the franchises of the corporation may be revoked whenever the legislature shall think proper. It is sometimes reserved conditionally; to be exercised only in case a certain event shall happen. The event may be one which the corporators could not control, or it may be such a one as could not occur without some default of their own. In either case the charter is repealable when the event happens.

In the charter now under consideration, the following clause occurs: "If the said company abuse or misuse any of the privileges hereby granted, the legislature may resume the rights granted to the said company." This was a reservation of the right to repeal the charter in case it should be violated. If it was violated, then the repeal was not breaking the bargain but keeping it; not *impairing*, but *enforcing* the obligation of the contract.

The plaintiffs' counsel insist that inasmuch as the right to repeal depended on matter of fact, the right could not be exercised until the fact was ascertained by a judicial trial. But if this were not a mistake the reservation would be nugatory. When the abuse of a charter is judicially ascertained, the corporation will be dissolved without the intervention of the legislature, and the court could not decide the fact to be true without pronouncing the judgment of forfeiture. The legislature certainly meant to reserve something more than the right to dissolve the corporation after it shall be dissolved by a court. The power to kill what is already dead is no power at all. The argument of the plaintiffs on this point is altogether unsustained by authority. There are several cases directly against it. In *Crease v. Babcock* (23 Pick. 234), the supreme court of Massachusetts said, that when the legislature reserved to itself the right to repeal a charter on the happening of a certain event, they might enact the repeal whenever the event happened; it was not a reservation of judicial power. To the same effect is *McLaren v. Pennington* (1 Paige 107); and in the *Miners' Bank v. The United States* (1 Greene 561), it was held, not only that the fact, on which the right of repeal depended, might be noticed by the legislature without the assistance of the judiciary, but that its truth could never afterwards be questioned by any court. Without intending to indorse the whole doctrine of the last-mentioned case, we are very clear that the right to repeal vests in, and may be exercised by, the legislature whenever the event occurs upon which they stipulated for the right. The most that can be said is, that the repeal is void if it comes before the event. If the corporators desire

to contest the validity of the repealing act in court, they must at least prove that the event did not occur.

This view of the subject makes it important that we should see whether the privileges of this company were abused or misused. Did the corporators violate the charter? We are obliged, as the case now stands, to answer this question in the affirmative. For that answer we have three reasons, either of which would be sufficient without the others. In the *first* place, we are bound to take an act of the assembly to be constitutional until the contrary is shown. In the absence of evidence, we presume the existence of every fact on which the validity of the law depends. *Secondly*: the plaintiff's bill does not aver that they performed their duties according to the terms of the charter; and this they certainly would have averred if they could safely have done so. *Thirdly*: a record of this court is referred to in the bill and produced in evidence, from which it appears that a decree was pronounced against them for fixing their terminus at a place not authorized, and for locating their road on streets and other highways in a manner expressly forbidden.

It is said that the repeal can be justified only if the violation of the charter was willful. But the right is given to repeal not for a willful, but for any abuse or misuse. The word *willful* is not in the reservation, and we can not insert it by construction. But suppose it to be in. Is not any positive violation of the charter, which might have been avoided, a willful misuse and abuse of it? They were not *forced* to lay out their road contrary to the plain directions of the law. Neither can we believe it to have been a mere blunder. The difference between what they were required to do and what they did do was too obvious and too important to be overlooked by men who could read and understand English. \* \* \*

But we are now dealing with an act of assembly which, if it be valid, is the paramount law of the subject to which it relates. It rides down and nullifies all other laws which are inconsistent with it. Perhaps this is the very first argument that ever was made to show that a statute was void because it conflicted with a rule of the common law. To change the common law and repeal earlier statutes is the main if not the only business which the legislature has to perform. A statute may be valid, no matter how inconsistent it is with the doctrine of estoppel, unless the doctrine of estoppel be a part of the constitution, which it certainly is not. When we are inquiring what the legislature *can* do, we are not helped a particle by being told what a court *would* do. When we are considering whether a statute ought to be obeyed or disregarded it is very unsatisfactory to be informed how the law stood a hundred years before the statute was passed. Judges and chancellors have established certain rules of proceeding for their own guidance in the distribution of justice among suitors. One of these rules is, that a party in certain cases shall not be permitted to aver the truth; and this is called an estoppel. But the legislature is not restricted by it. The general assembly can make and unmake all rules of practice, pleading and evidence at its pleasure.



The power that makes the law must, in its nature and essence, be so totally different from the power which administers the law that it is most illogical to reason from one to the other. The limitations on the legislative power of the state are not to be found in the general body of the law, but only in the constitution itself, which is the *lex legum*, or law of laws.

We must, therefore, fall back upon the constitution, to see whether there is anything there to prohibit the legislature from passing the act in question. That instrument declares that no law shall be made impairing the obligation of contracts. This charter was a contract; but one of its terms was, that it might be repealed if it should be abused or misused. The corporators did abuse and misuse it, and thus they placed themselves in the mercy of the legislature. Did the atonement, which they were compelled to make for their default, restore them again to the condition in which they would have remained if they had never been guilty of it? They had a charter, irrepealable if they would obey it, and they were independent of the legislature. But they fell from that estate by disobedience, and their charter became repealable. Did it become irrepealable again when they were forced by this court to undo the wrong they had committed?

These corporators have suffered at the hands of the legislature nothing but what they expressly agreed to suffer in a certain contingency. That contingency has literally come to pass. Their privileges have been abused and misused. But they insist that the penance they were forced to undergo ought to be accepted in place of the obedience which they promised. That is not in the bargain; and since they stand upon their contract, we do not see how we can give them more than what is there set down. The legislature agreed to disarm itself of the repealing power on condition that the corporators would remain and abide within their charter; when they went out of it the condition was broken. The fact that they left the path of duty is not disproved by the other fact that they afterwards returned to it. Nor is their case at all helped by showing that they were *driven* back under the lash of a court. Their independence of legislative control was to be a consequence of innocence; not of guilt, followed by repentance and restitution. \* \* \*

We think the construction we have given to this reservation is not only required by the established rules of interpretation, but is in accordance with the most liberal intent that can be ascribed to the legislature in making it. Men who are capable of abusing a privilege conferred on them by the special favor of the state are unworthy to have it. The state had a right to test the prudence of her bounty by this standard—to fix her own *locus penitentiae*—to try the grantees of the privilege and see whether they would behave themselves well. She kept in her hands the short, sharp remedy of repeal, to be applied whenever the conduct of the corporation would demonstrate that a remedy was needed. The error was to be repaired by the same body that committed it, at any time after the error was ascertained. For the same offense the charter might have been forfeited on *quo war-*



*ranto*, but another mode of reparation was adopted for the very reason that the state did not choose to undergo the risk and embarrassment, and delay of a judicial trial. She would not have the machinery of a court interposed between her and her rights. She did not desire to play with lawyers and judges at the game of special pleading. She was unwilling to go for justice to a place where estoppels might prevent her from asserting the truth. She would retain the right of legislative repeal free from all restraints but those imposed by the constitution, or else she would not grant the charter. If the corporators did not intend to obey it when such was the stipulated penalty for disobedience, it was folly as well as wickedness to accept it.

The authority given by the act of October, 1855, to the defendant to take possession of the railroad is asserted by the plaintiff's counsel to be an act of confiscation—a taking of private property for public use without compensation. If this be true, the injunction ought to be awarded, for no legislature can do such a thing under our constitution. When a corporation is dissolved by a repeal of its charter, the legislature may appoint, or authorize the governor to appoint, a person to take charge of its assets for the use of the creditors and stockholders; and this is not confiscation any more than it is confiscation to appoint an administrator to a dead man, or a committee for a lunatic. But money, or goods, or lands, which are or were the private property of a defunct corporation, can not be arbitrarily seized for the use of the state without compensation paid or provided for. This act, however, takes nothing but the road. Is that private property? Certainly not. It is a public highway, solemnly devoted by law to the public use. When the lands were taken to build it on they were taken for public use; otherwise they could not have been taken at all. It is true the plaintiffs had a right to take tolls from all who traveled or carried freight on it, according to certain rates fixed in the charter, but that was a mere franchise—a privilege derived entirely from the charter, and it was gone when the charter was repealed. The state may grant to a corporation, or to an individual, the franchise of taking tolls on any highway, opened or to be opened, whether it be a railroad or river, canal or bridge, turnpike or common road. When the franchise ceases by its own limitation, by forfeiture or by repeal, the highway is thrown back on the hands of the state, and it becomes her duty, as the sovereign guardian of the public rights and interests, to take care of it. She may renew the franchise, give it to some other person, exercise it herself, or declare the highway open and free to all the people. If the railway itself was the private property of the stockholders, then it remains theirs and they may use it without a charter as other people use their own—run it on their own account—charge what tolls they please—close it or open it when they think proper—disregard every interest except their own. The repeal of charters on such terms would be courted by every railroad company in the state, for it would have no effect but to emancipate them from the control of law, and convert their limited privi-

leges into a broad, unbounded license. On this principle a corporation might be rewarded, but never punished, for misconduct. Repeal of its charter, instead of bringing it to a shameful end, would put "length of days in its right hand, and in its left hand riches and honor." But it is not so. Railroads made by the authority of the commonwealth upon land taken under her right of eminent domain, and established by her laws as thoroughfares for the commerce that passes through her borders, are her highways. No corporation has any property in them, though corporations may have franchises annexed to and exercisable within them.

Such a franchise the plaintiffs had, but they have it no longer. The right to take tolls on a road is an incorporeal hereditament, which may be granted to a corporation or to an individual, and the grantee has an estate in the franchise. But what estate? The estate endures forever, if the charter be perpetual; for years, if it be given for a limited period; and at will, if it be repealable at the pleasure of the legislature. This corporation, after its privileges were abused, had an estate at will, and the commonwealth chose to demand repossession. That terminated the estate as completely as an estate for years would be terminated after the expiration of the term. The grant was exhausted, the corporation lived its time out. Its lease of life was expressly limited, at the day of its creation, to the period when the legislature should dissolve it for misconduct. When the legislative will was spoken, its hour had come. Having no right to keep the franchises any longer, it would be absurd to claim compensation for taking them away. To say that the stockholders have a right to compensation for the franchises, because they are wrongfully taken, and that they were wrongfully taken because they have a right to compensation, would be reasoning in a very vicious circle. If the stockholders had a right to retain the franchises, the charter could not be repealed at all, with or without compensation. If they had no right to retain them, they have no claim to compensation.

A brief recapitulation of the main points in the case may serve to make the grounds of our judgment somewhat plainer:

I. This charter was granted with a reservation of the right to repeal it, if the franchises should be abused or misused.

II. We are satisfied that, in point of fact, those franchises were abused and misused.

III. After that event happened, the general assembly was invested with full power to repeal the charter, and the corporators held their franchises from the state merely as tenants at will, in the same manner as if there had been an unconditional reservation of the right to repeal.

IV. After the interest of the corporators had been thus cut down by their own misconduct to an estate at will, the legislature only could enlarge the charter, so as to make it a perpetual grant, or put the corporators on another term of probation.

V. The judicial proceedings against the corporation did not and

could not disarm the legislature of its reserved right to repeal, nor enlarge the estate of the corporation in its franchises, nor change the terms of the original grant, for these are things which the judiciary can not do, nor the executive either.

VI. The power of the legislature is not restricted by the rules of pleading and evidence which the courts have adopted; and therefore the state may act in the legislature upon a truth which she would have been estopped to show in a court if the legislature had not interfered.

VII. The power to repeal for abuse of corporate privileges is a different right from that of demanding a judicial sentence of forfeiture, and is reserved for the very reason that it may afford a remedy when a *quo warranto* would not.

VIII. The charter being constitutionally repealed, the franchises are, as a necessary consequence, resumed to the state, and the road remains what it always was—public property.

IX. The corporators can not be entitled to compensation, for they had no property in the road, and after their default they held the corporate franchises at the will of the legislature, and the exertion of that will, in the resumption of the franchise, did them no injury but what they agreed to submit to. \* \* \*

(Upon a rehearing, concerning *abuse* and forfeiture, Black, J., continued):

There is nothing profound or mystical about these words. They are not terms of art in the law. The popular sense in which they are used every day is well known. To *abuse* is compounded of *ab* and *utor*; and in strictness it signifies to injure, diminish in value, or wear away, by *using* improperly. Catiline abused the patience of the Roman senate. A man abuses his constitution by excesses which impair vigor. A judge abuses his office, not only by taking bribes, but by any misconduct which detracts from its dignity and usefulness. To abuse the freedom of the press, or the right of debate, is a phrase from which we take a perfectly definite idea. We know very well what is meant when it is said that legislative authority or executive power has been abused. Why, then, are we expected *not* to know that a corporate privilege has been abused, when we see it used as a color and a pretext for that which the law pronounces a wrong and injury to the public? *Misuse* is a still simpler word. It signifies merely to *use amiss*. He who would prove that any power has not been misused must show that it has been always used rightly, or else not used at all.

But I admit that these words, like all others, may have different meanings, when spoken with reference to different subjects. Acts which would be an abuse of one thing may be no abuse of another. We are therefore to ascertain precisely what is abuse or misuse of corporate privileges by a company. Abuse includes misuse. We take them both together and define them thus: Any positive act in violation of the charter, and in derogation of public right, willfully done or caused to be done by those appointed to manage the general concerns of the corporation. Let us analyze this definition.

1. The illegal act must be *positive*. A mere *omission*, like the failure of a bank to make its annual returns, is not enough. *Nonuse* is a different thing from abuse or misuse. 2. A disregard of the charter which is injurious only to *private* interests, and which therefore admits of private compensation, is not, I think, within the fair meaning of the words. It must be some misconduct which infringes upon a right reserved by the state for the benefit of the public. 3. It must be *willful*; that is, not involuntary, accidental, or the consequence of mere mistake. But I mean mistake of *fact*. Every man is bound to know the *law*. Especially are the grantees of a privilege like this bound to know the law which limits and defines its extent. They bargained to obey the charter, not as they and their successors might happen to understand it, but according to its true intent and meaning. If we could allow them to have an advantage from their own errors of interpretation, then every grant of corporate privileges must be measured not by the terms of the grant itself, but by the ignorance of the grantees. A power not large when understandingly administered, might become enormous in the hands of dunces; and the dimensions of the same charter would dilate and contract in proportion to the degree of intelligence that each new set of directors would bring to the business. So high a premium for ignorance would cause it to be feigned sometimes, when it does not exist. The rule is a wise one which conclusively presumes that the managers of railroad companies, like everybody else, understand the law which prescribes their duties. 4. It can not be said that the company has been guilty of abuse and misuse every time a subordinate officer or agent transgresses the act of incorporation, without authority, express or implied, from the board of directors. It is not sufficient, for instance, that a conductor of his own head should charge an exorbitant fare. But if the directors should establish a tariff of tolls greater than the law allows, and compel the public to pay them, this would be a manifest abuse.

The plaintiffs have set up no excuse for their misconduct, except that they did not understand the act of incorporation. This is wholly inadmissible in point of law. As a matter of fact, it is more than doubtful. The act of incorporation fixed their terminus at the borough of Erie. They knew exactly where this was in 1842, when they got the charter. It is hard to see how anything but willful blindness could make them believe that a subsequent change in the limits of the borough, and its erection into a city, was an extension of their charter. But allowing this to pass, what can be said for their obstruction of roads and streets? They could not misread the command on that subject. The same clause forbids them to take down a dwelling-house, or run through a grave-yard. They could shut their eyes as easily on the whole as on a part of the prohibition. They had the charter six years before they struck a blow. There was time enough for deliberation and consultation. Then they used it as a color for the commission of public wrongs, which it expressly forbade. They lived in the guilt of these wrongs, and in the daily repetition of them,

for six years more, and yielded at last only to the power of an injunction. To say now that all this was involuntary, accidental; a mere innocent blunder, is not a *defense* but an *offense*. \* \* \*

There is not the faintest resemblance between the forfeiture and the repeal of a charter, except that dissolution of the corporation is a consequence of both. One is a legislative, and the other a judicial act. The power of the legislature and the power of the court are based on different foundations: are bestowed for different purposes, depend on different principles, are exercised in different ways, and their acts are valid or void for different reasons. The right of repeal (if it be reserved) is a limitation of the estate which the corporators have in the franchises; forfeiture takes away the franchises, whatever may be the extent of the grant. The commonwealth can come into one of her courts and claim a forfeiture only when there is no rule of law to forbid it; but a charter may be repealed without regard to the law, unless it be protected by some specific prohibition of the constitution. The law in some cases will enable a corporation, which is arraigned on a *quo warranto* to keep the truth away from the court, by pleading estoppel; but the constitution does not forbid the legislature to know and act upon the truth in any case, whatever. Courts, it is said, lean against forfeitures; and this is perhaps truer than it ought to be; but the legislative department of the government, when it has the control of a corporation, must be allowed to lean as it pleases. The annals of jurisprudence do not show that these two things have ever been confounded before.

Nor will it do to say that the facts and legal principles now invoked to save this corporation are part of the contract. The contract made the right of repeal dependent on the fact of misuse or abuse alone. If there was misuse or abuse, the repeal merely enforced the contract. It is alleged that, since the contract was made and broken, certain other things have been done which puts the parties in a new relation, and forbids the enforcement of the contract. It is unreasonable and contradictory in terms to say that what estops a party from setting up or claiming under a contract is, or can be, a part of the same contract. \* \* \*

*Injunction denied*, Lewis, C. J., and Woodward, J., dissenting.

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Sec. 461. Same.

See Flint and Fentonville Plank Road v. Woodhull, 25 Mich. 99-112, *supra*, p. 398.

**Sec. 462. (g) Repeal of general corporation laws.**

**DONWORTH & BEHAN v. COOLBAUGH ET AL., APPELLANTS.<sup>1</sup>**

1857. IN THE SUPREME COURT OF IOWA. 5 Iowa Rep. 300-308.

[Suit to enforce the statutory liability of shareholders in a plank road company, incorporated in 1851 under a general incorporation law of 1847, and providing a statutory liability. In 1853 judgment was obtained against the company, and no property being found this proceeding was taken. It was maintained by the defendants that since the general act of 1847 had been repealed, the liability of shareholders was gone. The court below ruled otherwise.]

WOODWARD, J. \* \* \* We can not concur in that position of the defendants, which maintains that the repeal of the act of 1847 took away the liability. We should not hold that this destroyed the corporation—that it took away all its rights by causing it to cease as a body corporate, nor, therefore, that its obligations, or those of its members, were blotted out. The act of 1847, with the articles adopted by a company organizing under it, constituted its charter; and they were, in relation to it, the same as a charter granted by the general assembly. The repeal of the act was but a repeal of it as a rule of future organizations, but not a repeal as to the past. This was a private corporation, and its existence could no more be taken away by the repeal of the general law than could that of one incorporated by private act, in which there were no provisions to that effect by the repeal of such act. The corporation still existed under that act, and that was the law of its existence.

This would seem to be the necessary construction, upon principle, in order to avoid an infringement upon well-established rules, in relation to private corporations and private rights; but the last section of chapter 43 of the code, which is the general incorporation act, and which went into force July 1, 1851, seems to conclude this question by providing that “nothing herein contained is intended to affect the interests of companies already organized further than is above expressed.” In this chapter it is enacted that corporations already existing may bring themselves under the provisions of the code by taking certain steps for that purpose and manifesting that design. But this company did not take any steps to bring itself under the law of 1851, and, therefore, it continued under that of 1847, and this is the law by which it is to be judged. \* \* \*

*Reversed upon other grounds.*

*Note.* See next case. See, also, 1899, *Watson Seminary v. County Court of Pike Co.*, 149 Mo. 57, 45 L. R. A. 675; 1904, *Grand Rapids & Ind. Ry. v. Osborn*, 193 U. S. 17.

<sup>1</sup>Statement abridged. Part of opinion omitted.



## Sec. 463. Same.

WILSON v. TESSON AND ANOTHER.<sup>1</sup>

1859. IN THE SUPREME COURT OF INDIANA. 12 Ind. Rep. 285-302.

PERKINS, J. \* \* \* The general banking law of 1852, under which the bank of the capital was organized, contained this provision: "The legislature may at any time alter or repeal this act," 1 R. S., p. 160, § 32. It was in the power then of the legislature to terminate the existence of banks, created under said act, at its pleasure; as it will scarcely be denied that a repeal of the law would work such termination.

The right to bank as a corporation was a franchise granted by the legislature—when the franchise was taken away the right ceased. And if the legislature could unconditionally terminate the existence of the banks by a repeal of the law, it could impose conditions upon which they might continue to exist. \* \* \*

In 1855 the legislature did repeal the banking law of 1852; for that body amended that law by substituting a new act covering all of the ground of the act of 1852, and also much additional. \* \* \*

It was as if the legislature had first expressly repealed the banking law of 1852, and then enacted the law of 1855. On the repeal of the act of 1852, the powers of the banks organized under it to do business as corporations ceased, unless the statute provided otherwise. *The State Bank v. The State*, 1 Blackf. 267; *Ang. and Ames on Corp.*, 2d ed., pp. 128, 667.

The statute did provide otherwise. The 48th section of the act of 1855 reads thus: "Every bank or banking association, organized under the provisions of the general banking law of this state may, in case it shall, immediately after the passage of this act, pay all its circulating notes in coin, upon demand, have until the first day of March, 1857, to wind up, or accept the provisions of this act." See, also, 1 R. S., p. 240, § 6. \* \* \*

The bank of the capital having failed to comply with the requirements of the act of 1855, had no power to do general banking business in its corporate capacity, after it came into force. We say nothing of its power as a private association. It is contended by the appellees that its powers continued till a forfeiture was judicially declared. This is not correct. In cases of corporations in whose charter no power of repeal is reserved, and a forfeiture is claimed for misuser or non-user, the doctrine of judicially declared forfeiture applies. *The State v. The Vincennes University*, 5 Ind. 77. It has no application to cases of a deprivation of power by a legislative repeal, in the exercise of an unconditional right reserved. The officers of the bank, in this case, then, having assumed to make a contract, in their capacity as such, which they had no power to make, the stockholders are not liable upon it as corporators. \* \* \*

*Reversed.*

*Note.* See argument annexed to this case.

<sup>1</sup> Argument and part of opinion omitted.

**Sec. 464. (2) Legislative power to amend.<sup>1</sup>**

- (a) Where there is no reservation of a power to alter or amend,—offer of an amendment.

**McSHERRY, J., IN JACKSON, GOVERNOR, ET AL. V. WALSH.**

1892. IN THE COURT OF APPEALS OF MARYLAND. 75 Md. Rep. 304-317, on page 316.

An act of assembly, amending an irrepealable charter, is void only when it attempts to vary the contract without the consent of the other party thereto. But, like any other contract, an irrepealable charter may be altered by the agreement of both the parties to it. Hence a legislative enactment that would without acceptance be invalid, becomes, when accepted by the corporation, perfectly valid and binding—the act and the acceptance constituting a new contract. The acceptance gives effect to that which would otherwise be inoperative. This is true in all cases where the only ground of objection to the statute is that it seeks to amend without previous assent an irrepealable charter. Standing alone, such an act would be nugatory, but coupled with an acceptance, actual or implied, it would be valid. An act of assembly which is absolutely and unconditionally void can not be made valid by consent. If the legislature has transcended the limits of its defined power, acquiescence will not aid its invalid enactment. But an amendment of an irrepealable charter is not absolutely void—it is only conditionally so. It is void provided it be not accepted or acquiesced in.

See note, § 473, *infra*.

**Sec. 465. Same. Acceptance is essential.**

See *Ashton v. Burbank et al.*, 2 Dillon 435, *supra*, p. 87; *Commonwealth v. Cullen*, 13 Pa. St. 133, *supra*, p. 417; *Hawthorne v. Calef*, 2 Wall. (U. S.) 10, *supra*, p. 752; *Ireland v. The Palestine, etc., Turnpike Co.*, 19 O. S. 369, *supra*, p. 757.

See note, § 473, *infra*.

<sup>1</sup> As to distinction between repeal, revoke, alter and amend, see 1900, *Wilmington City R. Co. v. Wilmington*, — Del. —, 46 Atl. Rep. 12.

Sec. 466. Same. Material amendment requires unanimous consent.

STEVENS v. THE RUTLAND AND BURLINGTON RAILROAD COMPANY.<sup>1</sup>

1851. IN CHANCERY, CHITTENDEN COUNTY, VERMONT. Appendix, 29 Vt. Rep. 545-566.

In this case the R. & B. R. Company were incorporated by an act of the legislature, passed in 1843, for the purpose of building a railroad "from some point at Burlington, thence southwardly through the counties of Addison, Rutland, and Windsor or Windham to some point on the west bank of Connecticut river." This road they constructed in accordance with the provisions of their charter, and the legislature then (in 1850) passed an additional act authorizing them to extend their road "from their present terminus in Burlington northwardly," etc., "to any point or points in the town of Swanton, in the county of Franklin," which act the company voted to accept as an amendment to their charter and were proceeding to carry out its purpose. To this amendment, and to the acceptance of it by a majority of the stockholders, and to the proposed action of the corporation under it, the complainant, who had previously become a member of the corporation by subscribing and paying for five shares of its capital stock did not assent, and brought his bill in chancery to enjoin the company from building the proposed extension.

BENNETT, CH. \* \* \* The question is, can the orator, upon such a state of facts, claim, at the hands of the chancellor, his injunction.

It is an admitted principle that in partnerships, and joint stock associations, they can not by a vote of the majority change or alter their fundamental articles of co-partnership or association against the will of the minority, however small, unless there is an express or implied provision in the articles themselves that they may do it. It is equally well settled that a court of chancery will, upon the application of an individual member of a partnership, or joint stock association, restrain, by injunction, the majority from using the funds or pledging the credit of the partnership or association in a business not warranted, and not within the scope of their fundamental articles of agreement. Courts of equity treat such proceedings by a majority *as a fraud* upon the other members, which they will neither sanction nor permit. To prevent the commission of fraud, by injunction, has been one of the earliest and most appropriate heads of equity jurisdiction, as well as to relieve against it when committed. It was upon this principle that Lord Eldon, when high chancellor, upon the application of a humble individual member of a company, which had been organized for the purpose of carrying on a fire and life insurance business, restrained

<sup>1</sup>Statement taken from syllabus. Part of opinion omitted. The decision was acquiesced in, and was not taken to a higher court.

the company, by injunction, from embarking also in the marine insurance business; though the applicant had paid into the funds of the company only one hundred and fifty pounds as a deposit upon fifteen shares, and the company gotten up by the Rothschilds of England, and composed of six or seven hundred individuals, with a capital of five millions sterling. See *Natusch v. Irving and others*; Gow on Part. Appendix 576. The same principle was applied to a corporation by the vice-chancellor, and by Lord Chancellor Brougham in the case of *Ware v. The Grand Junction Water Company*, 2 Rus. & Mylne, 470, S. C. 13 Cond. Ch. Rep. 126. The vice-chancellor, upon the application of a single shareholder, restrained the corporation, not only from embarking their funds and credit in a matter beyond the provisions of their charter, but also from applying to parliament for a change in the charter which would warrant it. The change desired to be made in that case was, that the company might be enabled to get their supply of water by means of an aqueduct from the river Colne instead of the river Thames, as authorized to do under their original charter. Lord Brougham, on appeal, dissolved that part of the injunction, it is true, which restrained the company from applying to parliament for an alteration of the charter in the particular desired, but retained the residue of it. So in *Cunliff v. The Manchester & Bolton Canal Company*, 13 Cond. Equity Rep. 131, note, the vice-chancellor restrained the corporation, upon the application of a shareholder, from applying to parliament for a change in their charter, to enable them to convert a portion of their canal into a railway, and from applying any of the corporate funds to the proposed object.

It was well conceded, in the argument on the defense, that if the corporation had been about to proceed to a construction of the contemplated extension without the act of 1850, it would have been a proper case for an injunction. The only question which can be open to debate is, as to what shall be the effect of the act of 1850, and a subsequent adoption of the act by the corporation, upon the individual rights of a shareholder who does not assent to its adoption. If bound by it, there is no equity in this bill. It is, and must be admitted, that the legislature has no constitutional power, unless it be reserved in the grant, to change or alter an act of incorporation without consent, and thereby cast upon the company new and additional obligations, or take from them rights guaranteed under the original charter. And, indeed, this the legislature have not attempted to do. It is also equally true that it is a part of the law of corporations that they act according to the voice of the majority. But it is to be remembered, that this is not a suit in which the plaintiff seeks to protect himself in any *corporate* right, but in his own *individual* right, growing out of the fact of his having become a corporator by his subscription and its payment, to the capital stock of the company. One of an aggregate corporation may contract with the company, as well as a third person, and the rights of the individual so contracting are no more distinct and independent in the one case than in the other. The plaintiff, by his subscription, assumed to pay to the corporation,

and only for the purpose specified in the charter, its amount, according to the assessments; and there was at the same time a TRUST created, and an implied assumption on the part of the corporation to apply it to that object and none other. \* \* \*

It is conceded that there is a class of alterations in a charter, which the corporation may obtain and adopt, that would not so essentially change the contract as to absolve the corporator from his subscription, or give him a right to complain in a court of justice, in case he had previously paid it. Where the object of the modification or alteration of the charter is *auxiliary* to the original object of it, and designed to enable the corporation to carry into execution the very purpose of the original grant, with more facility and more beneficially than they otherwise could, the individual corporator can not complain; and I should apprehend it would make no difference with the rights of a corporation, in such a case, though he could show that the charter, as amended, was less beneficial to the corporators than the original one would have been. The ground upon which such amendments bind the corporator, I deem to be his own consent. When he becomes a corporator by his signing for a portion of the capital stock, he in effect agrees to the by-laws, rules and votes of the company, and there is an *implied* assent, on his part, with the corporation, that they may apply for and adopt such amendments as are within the scope, and designed to promote the execution, of the original purpose; and he signs, and the corporation receive his subscription, subject to such implied contingency. \* \* \*

But suppose the object of the alteration is a *fundamental* change in the original purpose, and designed to superadd to it something which is beyond and aside of it; does the same principle apply? In the case of the Union Lock and Canal Company v. Towne, 1 N. H. 44, the company, under an act of the legislature of New Hampshire, passed December, 1808, were incorporated for *the purpose* of rendering the *Merrimac* river navigable from *Reed's Ferry* to *Amoskeag Falls*; and in this charter the company were authorized to purchase and hold real estate not exceeding six acres, and to exact and collect toll for a period of forty years only, at a rate not averaging more than twelve per cent. per annum on the capital stock invested. In June, 1809 (the 23d), the legislature passed an additional act which took off all limitation as to the rate of toll and time of its duration, and authorized the company to purchase and hold real estate not exceeding one hundred acres. \* \* \*

The court, in a well-considered opinion given by Judge Woodbury, held that each of the subsequent statutes created such a fundamental change in the original charter as to absolve the defendant from all liability for assessments made after the passage of the additional acts, there being no evidence to show that he had ever personally assented to them.

In the Middlesex Turnpike Corporation v. Locke, 8 Mass. 268, the court held that a variation and change in the course of the turnpike road, from that which was prescribed in the original charter, was such

a fundamental alteration as to absolve the subscribers from the payment of assessments made after the amendment to the charter, upon a subscription for stock, made before. \* \* \*

The case of the Hartford and New Haven Railroad Company v. Croswell, 5 Hill 383, has an important bearing upon the one before us. The amendment in that case to the original charter authorized the defendant to purchase, hold, and run upon the sound, steamboats, in connection with their railway, and gave the company, for that purpose, an increase of capital not exceeding two hundred thousand dollars. This seems to be nothing more or less, so far as principle is concerned, than an *extension* of the *terminus* of the road at New Haven, by steam power, on the railroad which the God of nature has made, instead of a railroad by land, constructed by the art of man. This amendment was accepted both by the directors of the company and by the corporation convened for that purpose; and yet it was held that the alteration was *fundamental*, and absolved the defendant from all liability for the assessments on his stock; there being no evidence that the defendant had personally assented to an acceptance of the amendment. \* \* \*

The consent or assent may, however, be *implied* in a class of cases, as has already been stated, where the amendment is not regarded as *fundamental*, and can be brought within the scope of the original purpose of the association; and this is going to the very verge of the powers of the corporation. It is difficult, and would be unwise, to attempt to lay down any general rules to determine in what precise cases the assent of the corporator should be implied, and in what not. It is sufficient for the present purpose to say, that his assent can not be implied, in a case like the present, from a majority vote. Courts may differ, and doubtless will, in regard to what alterations shall be sufficient to constitute a fundamental change. But in the present case, I think, on this point there can be but one opinion. The *termini* of the road, as fixed by the charter, are Burlington, and some point on the west bank of Connecticut river, in the county of Windsor or Windham. The capital stock is one million dollars, with a right in the corporation to increase it to an amount sufficient to complete said road and furnish the necessary apparatus for conveyance. The supplementary act of 1850 purports to authorize the corporation, within three years, to construct and extend their railroad from the terminus in Burlington, to some point in Swanton, in the county of Franklin, a distance of about thirty miles. \* \* \*

The franchise granted to this company was territorial, and an extension of the termini necessarily is an extension of the franchise. It can not remain the same thing in substance until it can be established that a part is equal to the whole. Besides, the company may increase the capital stock to such additional sum as shall be necessary to construct the extension.

The statute of 1850 is little less in effect, if anything, than an attempt to create in a summary manner, and by the way of reference, a new corporation, and to transfer all the old corporators to it. \* \* \*



It is not necessary that the business should be changed in kind to change the original purpose. If this is not a change in purpose it would not be to extend the road in one direction to Canada line, and in the other to Massachusetts line; and there would be no limits to the control which the corporation might acquire over the individual corporators, and this, too, without their consent, except what arises from the confines of legislative authority.

The change, then, in the charter being *fundamental* and the corporation not being able to bind the plaintiff by a majority vote, what must be the result? If he had been sued for an assessment upon his stock he might have claimed that he was absolved from all liability upon the acceptance of the amendment. And is not this reasonable? Shall it be said that the legislature and the corporation have power to embark this corporator in a speculation to which he has never consented? If it can be done in one case it can in another. But having paid his funds into the corporation he has a right in chancery to compel a faithful performance of the *trust* by the corporation, in conformity to the original charter, and to keep them within its purview. \* \* \*

In the case before us, it must follow, if the plaintiff is not bound by the conjoined effect of the act of 1850, and a majority vote of the corporation, the defendants can stand on no better ground than a voluntary association, who are about to go *beyond* and *aside* of their original articles against the will of a minority. This, in effect, was conceded in the argument. There was nothing improper in the passage of the act of 1850, though upon the application of a portion of the directors of the company, as stated in the bill. No attempt is made by the legislature to impair the obligation of any contract between themselves and the corporation, or to cast upon the company any new and additional burthens without their consent. There was no attempt to impair any contract arising under the prior charter between the corporation and the corporator as an individual, or disturb any vested right in either. The act is not *mandatory*; and there is, in fact, an implied condition annexed to it, that it is to be accepted by all whose individual and corporate interests are to be affected by it before it shall become operative. But suppose this act had been *mandatory* upon the corporation and the several stockholders to build this extension in the road within three years; would not all cry out against its palpable injustice? Suppose, instead of this, the legislature had left it optional with the corporation to accept or reject the act of 1850, and had provided that in case of the acceptance of the amendment by the corporation, it should bind the corporators who dissented from it, or did not assent to it, and this, too, in their individual rights; would there not be the same reason to cry out against it? Would it not, by its carrying a stockholder into an enterprise which he had never consented to, and change the principles of liability between the corporation and the individual corporator from what they were under the original compact, impair and disturb vested rights under it? I have no hesitation in saying, that, in my opinion, it

would be beyond the pale of the constitutional authority of the legislature. \* \* \*

If, in a case like the present, the majority can not bind the minority, it is plain that there is an equity in this bill, and that the defendants can stand in no better situation than if they had, by a vote of the company, proceeded to build the extension, and to apply the funds and credit of the corporation to that purpose, without any additional act of the legislature. The case of *Livingston v. Lynch et al.*, 4 Johns. Ch. 573, was the case of a voluntary association under the name of the North River Steamboat Company; and a majority, without the consent of the minority, changed by a vote the articles of association, and proceeded in their business according to their new articles. The bill was brought by the plaintiff against the majority of the company to have the rights of the association reinstated on their former basis; and the chancellor decreed the new articles *null and void*, and set up the old articles, and enjoined all further proceedings under the new articles. In the case of *Natusch v. Irving et al.*, which was also the case of a voluntary association, an injunction was allowed to restrain them from going into a business not within the scope of the original articles, in pursuance of a vote of the majority. And in that case, before the hearing, the defendant had offered to pay back all that the orator had paid into the company, with interest from the date of payment, and also to fully indemnify him against all loss by the transactions of the company already had or thereafter to be had in the business which was beyond their original articles. Lord Eldon, to this part of the case, replies, in substance, that it is not competent for any number of persons in a partnership (unless so provided for) formed for specified purposes, to affect that formation by calling upon some of their partners to receive back their capital stock and interest and quit the concern, which, in effect, would be merely *compelling* them to retire upon such terms as should be dictated to them, so as to form a *new company*; and that it is the *right* of a partner to hold his associates to the *specified purposes* whilst the partnership continues, and not to rest upon indemnities with respect to what he had not contracted to engage in; and that a partner can not be compelled to part with his shares, though for double what he originally gave for them; and that it may be his principal reason for keeping them, to have the partnership carried on according to the original contract. \* \* \*

I am not ready to suppose the directors in procuring the act of 1850 to be passed, or the corporation in accepting that act, acted in bad faith to any of the old stockholders; but doubtless they were governed by the most honorable motives and meant it for the best good of all concerned, notwithstanding the allegations in the bill. The case is not put at all upon the allegations in the bill imputing bad faith to the directors in obtaining the act of 1850. If it was it would be very material to the merits of the question that the bill should be answered. The ground assumed is, that this corporation had the funds of the original stockholders for an object distinctly defined in the original charter, and that they can not be allowed to apply them

to any other purpose whatever without the consent of the stockholders, and that to do it would be a breach of trust. \* \* \*

Where it is clearly shown that a corporation is about to exceed its powers and to apply their funds or credit to some object beyond their authority, it would, if the purpose of the corporation was carried out, constitute a breach of trust; and a court of equity can not refuse to give relief by injunction. See, *Aagar v. The Regent's Canal Company*, Cooper's Eq. 77; *The River Dun Navigation Company v. North Midland Railway Company*, 1 Railway Cases 135, 153-4. \* \* \*

Injunction allowed, subject to further orders. See note, § 473, *infra*.

**Sec. 467. Same.** An immaterial amendment can be accepted by a majority.

**SPRAGUE v. THE ILLINOIS RIVER RAILROAD COMPANY.<sup>1</sup>**

1857. IN THE SUPREME COURT OF ILLINOIS. 19 Ill. Rep. \*174-\*183.

[Bill by Sprague, a tax-payer, to enjoin the enforcement of a subscription of \$50,000 made under authority, by Cass county, to the stock of the railroad company, upon the ground that the company had or were about to accept material amendments made to the charter after the company was incorporated and the subscription made. Court below dismissed the bill.]

CATON, C. J. We do not think that the amendment to the charter to the Illinois River Railroad Company, which was passed in 1854, authorizes an essential and material departure from the purposes and objects specified in the original charter of that company, so as to make it a separate and distinct enterprise. The original charter provides as follows: "And the said company are hereby authorized and empowered to locate and construct and finally complete a railroad from the town of Jacksonville, in Morgan county, via Virginia, in Cass county, to the town of Bath, Mason county, and thence by way of Pekin, in Tazewell county, Lacon, in Marshall county, to La Salle, in La Salle county." The amendment of the charter of 1854 authorized the company to unite or consolidate with any other road built, or to be built, and to make connections with such road at any point on the route of the Illinois River Railroad, and that they should not be required to build their road north of that point, unless a majority of the board of directors should think proper to do so.

We have nowhere met with a more satisfactory exposition of the general principles of law, governing the respective rights of corporations and individual stockholders therein, as connected with this subject, than in the case of *Banet v. The Alton & Sangamon Railroad Company*, 13 Ill. R. 504. In determining the question as to how far the original purposes of a corporation may be departed from, after

<sup>1</sup> Statement abridged. Part of opinion omitted.

subscriptions have been made to its stock, without violating the rights of the stockholders individually, we must first consider with what intention, and in view of what advantages, the law must presume such subscriptions were made. As is clearly manifest from the decision of the case above referred to, the conclusive presumption is that it was with a view to the profits to be derived from the stocks thus subscribed, as an investment, and not in reference to any incidental advantages which may accrue to the stockholders by reason of the construction of the improvement, in consequence of any anticipated enhancement of any other property which the stockholder may own, or otherwise. To admit any other presumption would be, in fact, a fraud upon the other stockholders. If the various collateral considerations which may have induced the different shareholders to subscribe for the stock can be taken into consideration in determining in what manner the common enterprise may be carried out or executed, the common good of all must frequently be sacrificed to the particular good of one individual shareholder. If the various collateral considerations which induced each individual, composing the corporation, to subscribe for his stock, are to control in the execution of the enterprise or the management of the concern, it might frequently, and probably would in almost every case, be utterly impossible to carry on or complete it, for the reason that such collateral considerations or incidental inducements might be directly hostile to each other; to gratify one would be to destroy the other. No inducement or consideration, but that which is supposed to promote the common good of all can be sanctioned by justice or presumed by the law to exist. The presumption, then, is that each one, when he enters into the association, agrees to do, and consents to have done, whatever may be supposed will and is intended to make the undertaking a success, and the investment a profitable one.

In the commencement of an undertaking like that of a railroad, no human sagacity can foresee every contingency which may arise, or anticipate every obstacle which may present itself, in its prosecution, and all must know and anticipate that these contingencies or obstacles may make it necessary, for the common good, to make many and even important changes in the original plan, and each one is presumed to anticipate that such changes may become necessary, and to consent to them, when the majority, or those entrusted with the management of the common interest, shall deem it best (for the common good). It will not do to say that the subscriber is only presumed to consent to such changes or acts as are expressly authorized by the charter as it exists when he subscribes, and that he is always to be considered as protesting to any change of that charter or enlargement of the powers of the corporation, no matter how manifestly it may promote the common good of all. Such a rule would, in all cases, preclude the possibility of ever altering the charter of any corporation, without the express consent of all the shareholders. Then might one stupid or obstinate holder of one share tie up the hands of all the rest, to their utter ruin. Such a proposition needs no refutation. The history of

private corporations, and the legislation of all countries in reference to them, show that no sane man ever became a corporator with such an understanding or intention. There must be a palpable abuse of power by the majority, or governing authority, to the prejudice of the minority or dissenting portion, before the courts would be authorized to declare its exercise illegal. If the act is performed in good faith and with the real intent to promote the best interest of the concern, even though it might turn out disastrously, the act would be none the less legal. Bad faith or fraud would vitiate such acts, as well in these as in other cases. It is true that the original purpose or object of the corporation may not be entirely changed, or abandoned, and a new one undertaken—such as a railroad abandoned for a canal, or line of steamboats, or, possibly, one railroad route abandoned, and another, in an opposite direction and which could have no affinity to or connection with the first, adopted; but we know of no instance where the mere limitation or enlargement of the original plan or purpose has been held not to be within the implied powers of the majority or controlling authority. The great extent of this implied power, conferred by each shareholder upon the majority or controlling authority of the corporation, or the nature of his implied agreement on this subject when he becomes a member of the corporation, may be familiarly illustrated by the history of railroad corporations from their first beginning to the present time, both in this country and in Europe. Take, for instance, the great New York Central Railroad. That was originally constructed and for many years operated by some seven or eight separate and distinct corporations. Subsequently an act of the legislature was passed, authorizing them all to consolidate, so that all should constitute but one company, owning and operating as one road all the different sections and branches formerly owned and operated by them separately; and this was done without the unanimous consent of all the stockholders of all the original corporations; to have required that, would have rendered the consolidation an impossibility, no matter how manifestly the proposed measure might have been for the common good of all; so many stockholders would have been found opposing it, with the intention of being bought up to give a consent which, in reality, their own interest demanded that they should give voluntarily, that nothing could ever have been done. It is a lamentable truth, that the history of human affairs shows that such is human nature, as exemplified by too many. The ever-ready answer is, "May I not do with my own as I will?"

Let us now see how this consolidation affected the individual stockholders of the separate original corporations. Take, for instance, one who subscribed stock for the construction of the road between Albany and Schenectady. When he made that subscription he only expressly consented to become a part owner of that small section of road, some sixteen miles long; and had he been asked, instead of becoming a part owner in that small enterprise, where his relative interest might be so considerable that his influence in its management might be sensibly felt, to become a part owner in that gigantic corpora-



tion as we now see it, he might very likely, and in all probability would, have refused to engage in it. And yet, having subscribed under these circumstances, all his subsequent remonstrances could prove of no avail, when the majority of his associates thought it for the interest of the whole to enter into the consolidation. Indeed the original stock, for which alone he subscribed, was taken from him, or rather destroyed, and he was compelled to take, in lieu thereof, stock in another company, to which he never subscribed or consented to be connected with. And this new company exhibits purposes and objects so much more extended than the old, that it is hardly proper even to call them of the same general character. \* \* \*

But it may be objected that this course of legislation and action, however uniform and long continued, can not acquire the force of constitutional law, or rather of constitutional construction, and that this question involves the sacred right of individuals to possess, manage and enjoy their own as they may think best, as well as the right of contract, express or implied, upon entering into these associations. On the contrary, we think they are of the highest authority, in both points of view. Such a long-continued and uniform acquiescence in the exercise of this power, by those interested in the stocks of these corporations, and by the profession, shows the undoubted understanding of all, that this is a rightful and necessary exercise of power; and he is a bold man indeed, who, supposing that he has been favored with some glimmer of constitutional light which has never been vouchsafed to any other, shall hold that this has all been but a usurpation of power, and a ruthless trampling upon individual rights. \* \* \*

No rational man, upon becoming a member of a corporation, can suppose that for him the course of legislation is to be changed, and the mode of managing corporate concerns is to be subverted. He must expect that his interest will be managed in the same way that all others, under like circumstances, have always been managed; and to this he must be presumed to consent and agree at the time. He must be held to consent that the charter of the corporation may be amended, by enlarging or limiting its powers, or by modifying, limiting or extending its objects and purposes, in the same manner and to the same extent that other corporate charters have previously been changed; and that such amendment of the charter may be accepted, by the express vote of a majority of the stockholders in interest, or of the directors or managers of the corporation, either by a direct vote or by acting under it, or by any other mode of adoption known to the law. This seems to us so perfectly manifest that we deem it unnecessary to enlarge upon it.

By applying these principles to the case before us, we see there was nothing in the amendment of the charter passed in 1854, the acceptance of which by the corporation could in the least violate any of the rights of any of the subscribers to the stock. \* \* \*

*Affirmed.*

See note, § 473, *infra*.



**Sec. 468.** (b) Power to amend under a reserved power to amend,—extent of authority.

See TOMLINSON v. JESSUP, 15 Wall. (U. S.) 454, *supra*, p. 754.

See note, § 473, *infra*.

**Sec. 469.** Same. General limits of legislative authority under the reserved power to amend.

**CITY OF DETROIT v. DETROIT & HOWELL PLANK ROAD CO.<sup>1</sup>**

1880. IN THE SUPREME COURT OF MICHIGAN. 43 Mich. Rep. 140-149.

[In 1848 the road company was incorporated to build a road from Detroit to Howell, which was duly completed. The act of 1848 provided that the legislature "may at any time alter, amend or repeal this act" after thirty years. In 1879 the legislature provided that no plank road company shall, without the consent of the local authorities, keep or maintain a toll-gate within the present or future limits of any city or village, or shall collect toll for any portion of its road within such limits, and shall remove the same beyond the city limits within sixty days after notice from the city to do so.]

COOLEY, J. A mandamus is applied for in this case to compel the respondent to remove beyond the city limits a toll-gate located on Grand River street. The questions the application presents are questions of statutory construction and of constitutional law. \* \* \*

The toll-gate of the respondent on Grand River street is within the existing corporate limits of the city of Detroit, and the city authorities notified the respondent to discontinue and remove the same more than sixty days before this proceeding was instituted. The respondent denies the validity of the act of 1879, and refuses to conform to it. It is admitted that but for the act of 1879 respondent might lawfully maintain the gate where it is, the city having been extended to embrace it since the gate was located. *Chope v. Detroit & Howell P. R. Co.*, 37 Mich. 195.

The effect of this legislation, if valid, would be to take from respondent about two miles and a half of the road upon which it now collects toll. It is not pretended that this is done by reason of any forfeiture done or suffered by the respondent, and, if it were, a judicial finding would be necessary. *Flint, etc., Plank Road Co. v. Woodhull*, 25 Mich. 99. Nor is it claimed that the act of 1879 was passed as a regulation of police. It would probably be conceded that it goes quite beyond the competency of an act of mere regulation, and that it must be sustained, if at all, as an act passed in the exercise of that complete power to amend and repeal, which was reserved

<sup>1</sup> Statement abridged. Part of opinion omitted.

in passing both the general act of 1848 and the charter of respondent. The city relies upon it as an exercise of that power, and not otherwise. \* \* \*

There are cases in which amendments to charters having some resemblance to this have been sustained, but it is in general easy to distinguish them. Many of these are cited in the brief for the relator. *Commissioners v. Holyoke Co.*, 104 Mass. 446, in which a company having a dam across the Connecticut river was required to construct a fish-way, was a case involving a mere police regulation for the preservation of rights of others in the fishery above and below. All the following cases involved the same principle: *Commonwealth v. Eastern R. Co.*, 103 Mass. 254, where a railroad company was required to build a station-house and stop its trains at a certain locality; *Albany, etc., R. Co. v. Brownell*, 24 N. Y. 345, in which it was held competent to require a railroad company to permit and provide for the crossing of its track by highways; *Roxbury v. Boston R. Co.*, 6 Cush. 424, in which a like question was involved; *English v. New Haven, etc., Co.*, 32 Conn. 240, in which a bridge, made necessary for the convenience of a railroad company, and used by the company and the public, was required to be made wider by the company; *Worcester v. Norwich, etc., R. Co.*, 109 Mass. 103, in which the railroads coming into a city were required to unite in a common passenger station at a point to be determined by commissioners; *Meadow Dam Co. v. Gray*, 30 Me. 547, in which a company incorporated to build a dam across a river was required to construct a lock for purposes of navigation; and there are many others of the same sort. Cases involving only the right to change the methods or the extent of taxation may be dismissed altogether from consideration, as this right must always exist when there is no express contract to the contrary. *East Saginaw Salt M'f'g Co. v. East Saginaw*, 13 Wall. 373. So may cases involving only the question of the liability of corporations to the control of the general police laws of the state. *Beer Company v. Massachusetts*, 97 U. S. 25; *Fertilizing Company v. Hyde Park*, 97 U. S. 659.

But there is no well-considered case in which it has been held that a legislature, under its power to amend a charter, might take from the corporation any of its substantial property or property rights. In some cases the power has been denied where the interest involved seemed insignificant. The case of *Albany, etc., R. Co. v. Brownell*, 24 N. Y. 345, is an illustration. It was there decided that although the legislature might require railroad companies to suffer highways to cross their tracks, they could not subject the lands which the companies had acquired for other purposes to the same burden, except in connection with provision for compensation. The decision was in accord with that in *Commonwealth v. Essex Co.*, 13 Gray 239, 253, in which, while the power to alter, amend or repeal the corporate franchises was sustained, it was at the same time declared that "no amendment or alteration of the charter can take away the property or rights which have become vested under a legitimate exercise of the

powers granted." The same doctrine is clearly asserted and affirmed in *Railroad Company v. Maine*, 96 U. S. 499, and is assumed to be unquestionable in the several opinions delivered in the *Sinking-Fund Cases*, 99 U. S. 700.

But for the provision in the constitution of the United States which forbids impairing the obligation of contracts, the power to amend and repeal corporate charters would be ample without being expressly reserved. The reservation of the right leaves the state where any sovereignty would be if unrestrained by express constitutional limitations, and with the powers which it would then possess. It might, therefore, do what it would be admissible for any constitutional government to do when not thus restrained, but it could not do what would be inconsistent with constitutional principles. And it can not be necessary at this day to enter upon a discussion in denial of the right of the government to take from either individuals or corporations any property which they may rightfully have acquired. In the most arbitrary times such an act was recognized as pure tyranny, and it has been forbidden in England ever since *Magna Charta*, and in this country always. It is immaterial in what way the property was lawfully acquired; whether by labor in the ordinary avocations of life, by gift or descent, or by making profitable use of a franchise granted by the state; it is enough that it has become private property, and it is then protected by the "law of the land." Even municipal corporations, though their charters are in no sense contracts, are protected by the constitution in the property they rightfully acquire for local purposes, and the state can not despoil them of it. *Terrett v. Taylor*, 9 Cr. 43; *Pawlet v. Clark*, 9 Cr. 292; *State v. Haben*, 22 Wis. 629; *People v. Common Council*, 28 Mich. 228.

We have said nothing of those cases in which charters have been amended by limiting the tolls that may be taken, as it is conceded by relator that that is not what has been attempted in this case. It was a part of the original contract that the tolls should not be reduced by the state until the annual returns should realize to the stockholders ten per centum annually on their investment, and it is not claimed that that limit has been reached. What the state claims a right to do is to deprive the respondent of the privilege any longer to take tolls for travel and traffic on two miles and a half of its road. If it may do this in respect to one part of the road, it may in respect to any other part. If it may exclude the respondent from Detroit it may from Howell also, or from any township on the line, and a single section of a statute may annihilate the property of respondent altogether. A statute which could have this effect would not be a statute to amend franchises, but a statute to confiscate property; it would not be a statute of regulation, but of spoliation. \* \* \*

*Mandamus denied.*

See note, § 473, *infra*.

**Sec. 470. Same.** Acceptance is essential, under the reserved power also.

See *Yeaton v. Bank of the Old Dominion*, 21 Grattan (Va.) 593, *supra*, p. 750.

See note, § 473, *infra*.

**Sec. 471. Same.** Power of the majority to accept an amendment under the reserved power of the state to amend,—May accept.

**BUFFALO AND N. Y. CITY R. CO. v. DUDLEY.<sup>1</sup>**

1856. IN THE COURT OF APPEALS OF NEW YORK. 14 N. Y. Rep. 336-356.

[Appeal from judgment in favor of the railroad company upon a suit to recover the amount subscribed by Dudley to the capital stock of plaintiff. The company was incorporated in 1845 with a capital stock of \$750,000, and authority to build a railroad from Hornellsville to Attica, sixty miles. The right to alter or repeal was reserved to the legislature. After the subscription was made the legislature authorized the company to change its name, increase its capital stock to \$1,500,000, and extend its road to Buffalo, thirty-one miles farther; all of which was accepted by the directors. Calls were duly made but the defendant refused to pay on the ground that the changes were detrimental to his interests and made without his consent.]

T. A. JOHNSON, J. \* \* \* The subscription having been valid, so as to give a right of action, in case of non-payment, to the corporation, did the alteration of the charter and the extension of the road subsequently absolve the defendant from his liability upon such subscription? This question is, I think, entirely settled by the decision of this court in the case of *Schenectady and Saratoga Plank Road Company v. Thatcher* (1 Kern. 102). The right to alter was reserved in the charter, and the subscription must be taken to have been made subject to having such additional powers conferred as the legislature might deem essential and expedient. The change is not fundamental. The new powers conferred are identical in kind with those originally given. They are enlarged merely, the general objects and purposes of the corporation remaining still the same. It may be admitted that, under this reserved power to alter and repeal, the legislature would have no right to change the fundamental character of the corporation and convert it into a different legal being, for instance, a banking corporation, without absolving those who did not choose to be bound. But this they have not attempted to do. The additional

<sup>1</sup> Statement abridged. Only those parts of opinions given that relate to the single point.

powers are of the same character, and have been regularly acquired from the legitimate source of power, and if they have been fairly exercised, the defendant, although the change may have operated to his pecuniary disadvantage, is still bound by his undertaking. It is no breach of the agreement between the plaintiff and the defendant. \* \* \*

SELDEN, J. \* \* \* The point made by the defendant upon the alteration of the plaintiff's charter, changing the name of the corporation and authorizing the extension of its road from Attica to Buffalo, must, I think, be considered as sufficiently answered by the decision of this court in the case of *The Schenectady and Saratoga Plank Road Company v. Thatcher* (1 Kern. 102.) The power reserved to the legislature in the original act of incorporation, to alter or repeal the act, is as broad in this case as in that. It is, indeed, entirely unlimited. Under the rule established in that case, no mere addition to or alteration of the charter, however great, would operate to discharge a stockholder from his obligation to the corporation. To work such a discharge the charter must be repealed, or the legislation must be such as virtually to subvert the corporation itself; or, at least, to destroy its identity. \* \* \*

*Affirmed.*

See note, § 473, *infra*.

## Sec. 472. Same.

### DURFEE v. OLD COLONY AND FALL RIVER RAILROAD COMPANY.<sup>1</sup>

1862. IN THE SUPREME JUDICIAL COURT OF MASSACHUSETTS. 5  
Allen (Mass.) Rep. 230-248.\*

Bill in equity brought by the plaintiff, a minor, by John S. Brayton, his guardian, to restrain the defendants, a railroad corporation established under the law of this commonwealth, and the directors thereof, from proceeding to act under St. 1861, ch. 156, authorizing them to extend their railroad to the line of the state of Rhode Island, or under St. 1862, c. 149, authorizing their union with the Newport and Fall River Railroad Company.

BIGELOW, C. J. \* \* \* The case for the plaintiff mainly rests on the single proposition of law, that a corporation established by the legislature of this commonwealth by acts which, under St. 1830, ch. 81, are subject to alteration, amendment or repeal, at the pleasure of the legislature, can not engage in any new enterprise or enter upon any new undertaking, in addition to that contemplated by and embraced in the original charter of the company, against the consent of any one of its stockholders, although such new enterprise or undertaking is of the same kind with that for which the corporation was originally established, and is authorized, sanctioned and adopted by an express legislative grant, and by a vote of the majority of the stockholders duly ascertained according to law.

<sup>1</sup> Statement abridged. Arguments and part of opinion omitted.

[After stating that no question arises here between the legislature and corporation, or upon an executory contract entered into with the corporation, as an agreement to subscribe for stock and to become a member of a corporate body created or to be established for certain distinct and designated objects..]

We suppose it may be stated as an indisputable proposition, that every person who becomes a member of a corporation aggregate, by purchasing and holding shares, agrees, by necessary implication, that he will be bound by all acts and proceedings, within the scope of the powers and authority conferred by the charter, which shall be adopted or sanctioned by a vote of the majority of the corporation, duly taken and ascertained according to law. This is the unavoidable result of the fundamental principle that the majority of the stockholders can regulate and control the lawful exercise of the powers conferred on a corporation by its charter. A holder of shares in an incorporated body, so far as his individual rights and interests may be involved in the doings of the corporation, acting within the legitimate sphere of its corporate power, has no other legal control over them than that which he can exercise by his single vote in the meetings of the company. To this extent he has parted with his personal right or privilege to regulate the disposition of that portion of his property which he has invested in the capital stock of the corporation, and surrendered it to the will of a majority of his fellow corporators. The *jus disponendi* is vested in them so long as they keep within the line of the general purpose and object for which the corporation was established, although their action may be against the will of a minority, however large. It can not, therefore, be justly said that the contract, express or implied, between the corporation and the stockholders is infringed or impaired by any act or proceeding of the former which is authorized by a majority, and which comes within the terms of the original statute creating and establishing their franchise, and conferring on them capacity to exercise control over the rights and property of their members. On the contrary, the fair and reasonable implication resulting from the legal relation of the stockholder and the corporation is, that the majority may do any act, either coming within the scope of the corporate authority, or which is consistent with the terms and conditions of the original charter, without and even against the consent of an individual member.

Such being the nature of the contract which subsists between the corporation and each of its members, we have only to inquire, in the present case, whether it has been in any respect violated by the present defendants. The answer to this inquiry will be found in the interpretation which is put on that clause of the general laws of this commonwealth already cited, by which a right is reserved to the legislature to amend, alter or repeal any act of incorporation which has been established by its authority since the enactment of that provision in the statute of 1830. Whatever may be the extent of the authority which is thereby retained by the legislature to modify or change the charters of corporations without or against their consent, there would



seem to be no reason to doubt that, with the concurrence of the corporation manifested in the mode pointed out by law, the legislature may make any alteration in or addition to the power and authority conferred by the original act of incorporation, and not foreign to the purposes and objects for which it was enacted, and which it was designed to accomplish, which may seem to be expedient or necessary. No breach of contract would be thereby occasioned. Such action would be in precise accordance with the terms on which the grant of the franchise was made. In creating a corporation no contract is made by the legislature with the individual members or stockholders, any further than they are represented by the artificial body which the act of incorporation calls into being. They have no other rights except those which exist or grow out of the constitution of the body corporate, of which they are members. To this only can we look, in order to ascertain whether there has been any breach of contract or violation of chartered rights. It constitutes, of itself, the contract by which the rights of all parties are to be governed. When, therefore, it is expressly provided between the legislature on the one hand and the corporation on the other, as part of the original contract of incorporation, that the former may change or modify or abrogate it or any portion of it, it can not be said that any contract is broken or infringed when the power thus reserved is exercised with the consent of the artificial body of whose original creation and existence such reservation formed an essential part.

The stockholder can not say that he became a member of the corporation on the faith of an agreement made by the legislature with the corporation, that the original act of incorporation should undergo no change except with his assent. Such a position might be asserted with more plausibility, if there was an absence of a clause in the original act of incorporation providing for an alteration in its terms. In such a case it might perhaps be maintained that there was a strong implication that the charter should remain inviolate, and that the holders of shares invested their property in the corporation relying upon a contract entered into between it and the legislature that the provisions of the act creating it should remain unchanged. But it is difficult to see how such a construction can be put on a contract which contains an express stipulation that it shall be subject to amendment and alteration. If it be asked by whom such amendment or alteration is to be made, the answer is obvious: by the parties to the contract, the legislature on the one hand and the corporation on the other; the former expressing its intention by means of a legislative act, and the latter assenting thereto by a vote of the majority of the stockholders, according to the provisions of its charter. It is nothing more than the ordinary case of a stipulation that one of the parties to a contract may vary its terms with the assent of the other contracting party. In such case, all persons claiming derivative rights or interests under the original contract, with notice of its terms, would be bound by the amendment or alteration to which the parties should agree. \* \* \*

The infirmity of the argument in behalf of the plaintiff is, that it admits that an amendment may be legal and valid as to the corporation, if they assent to it by a vote of the majority, while at the same time it sets it aside as against the stockholder who refuses to sanction it, on the ground that as to him it is illegal and void. But we can not see how the amendment can be said to be legal and illegal *uno et eodem flatu*. If it is valid as to the corporation, for the reason that they have accepted and approved it according to the provisions of their charter, it would seem that it must also be binding on the stockholder, who has agreed that his rights and interests in the corporation shall be regulated and controlled by a vote of a majority, acting in conformity to the original constitution of the corporation, and within the scope of its corporate powers. The real contract into which the stockholder enters with the corporation is, that he agrees to become a member of an artificial body which is created and has its existence by virtue of a contract with the legislature, which may be amended or changed with the consent of the company, ascertained and declared in the mode pointed out by law. Having, by virtue of the relation which subsists between himself and the corporation as a holder of shares, assented to the terms of the original act of incorporation, he can not be heard to say that he will not be bound by a vote of the majority of the stockholders accepting an amendment or alterations of the charter made in pursuance of an express authority reserved to the legislature, and which by such acceptance has become binding on the corporation. Such we understand to be the result of the adjudicated cases. In *Crease v. Babcock*, 23 Pick. 342, it was expressly decided that corporators, by accepting a charter, directly agree to adopt the provision reserving to the legislature the right to amend, alter or repeal the act of incorporation as a constituent part of their contract; and it has often been decided, under similar provisions in the statutes of other states, that amendments or changes, either abridging the corporate authority or enlarging and extending it so as to embrace new enterprises and to incur additional burdens and liabilities, when duly adopted by the corporation, are valid and binding on a dissenting minority, as well as on those corporators by whose votes the amending act has been accepted and approved. *Buffalo, etc., Railroad v. Dudley*, 4 Kernan 336, 348, 354; *Northern Railroad v. Miller*, 10 Barb. 260; *Meadow Dam Co. v. Gray*, 30 Maine 547; *Oldtown, etc., Railroad v. Veazie*, 39 Maine 580; *Banet v. Alton, etc., Railroad*, 13 Illinois 504.

It was urged, as a grave objection against the doctrine above stated, that it puts the minority of the stockholders of a corporation entirely within the control of the legislature and a majority of the stockholders, and that there would be no limit or restraint placed on the exercise of the power, so that corporations might be diverted to purposes and objects wholly foreign to those for which they were originally established, and stockholders might be made to participate against their will in undertakings which they never contemplated and which they deemed inexpedient or ruinous. If this be so, it is a con-

sequence of which no stockholder can reasonably complain, because it is a result which flows from the contract into which he has voluntarily entered. But we are not prepared to admit the soundness of the objection. A restraint or limit on the power of the legislature to alter or amend a charter, even with the consent of the corporation, may perhaps be found in the doctrine recognized in some of the English cases, that the enlargement of corporate powers shall not be extended so as to authorize enterprises or operations different in their nature and kind from those comprehended within the terms of the original charter, but shall be confined to purposes and objects *ejusdem generis* with those for which the corporation was primarily granted. See *Ware v. Grand Junction Water Works*, 2 Russ. & Mylne 470; *Ffooks v. Southwestern Railway*, 1 Sm. & Gif. 142. But however this may be, no such question arises in the present case, inasmuch as the additional acts, the validity of which is called into controversy by the plaintiff, do not empower the defendants to engage in any undertaking essentially different in kind from that which was embraced in the original acts by which their corporate existence under their present name was authorized and established.

So far as any argument against the right of the legislature to amend or alter the charters of corporations under our statutes is drawn from the peril to which it exposes the property and interests of dissenting minorities of stockholders, we can not deem it of any practical weight or importance. The good faith of the legislature and the self-interest of the majority will ordinarily be a sufficient protection against any wanton or oppressive use of their power. Against any dishonest or fraudulent abuses of it, a sufficient remedy can always be had in the courts of justice.

It may be well to add, in order to avoid misapprehension, that we do not intend to say that the legislature have any power to change or modify an act of incorporation in such a way as to affect in a material particular a contract which they have entered into with a third person. Such an exercise of legislative power would be unconstitutional and invalid, because it would impair the obligation of a contract. \* \* \*

*Bill dismissed.*

See note, § 473, *infra*. 1902, *Wuerfler v. Trustees Grand Grove, etc.*, 116 Wis. 19, 96 Am. St. R. 940; 1904, *Wright v. Minnesota Mut. Ins. Co.*, 193 U. S. 657.

**Sec. 473. Same.** Majority can not accept a material amendment against the protest of the minority.

**ZABRISKIE v. THE HACKENSACK AND NEW YORK RAILROAD COMPANY.<sup>1</sup>**

1867. IN THE COURT OF CHANCERY OF NEW JERSEY. 18 N. J. Eq. (3 C. E. Green) Rep. 178-194.

[Application by plaintiff, the holder of 930 shares of the stock of defendant company, for an injunction to restrain it from extending its

<sup>1</sup> Statement abridged. Arguments and part of opinion omitted.

road and executing a certain mortgage authorized by an act of the legislature of 1861. The company was incorporated in 1856 (the power to alter or amend being reserved), to build a railroad five miles long, with a capital stock of \$200,000, and with the privilege of mortgaging its property to the extent of \$50,000. The act of 1861 authorized an extension of twelve miles, an increase of stock to any amount necessary, and the issue of bonds to the extent of \$250,000. The corporation by the directors and a majority of the shareholders accepted these authorized amendments, and commenced the extensions contemplated.]

**THE CHANCELLOR (ZABRISKIE).** \* \* \* The extension authorized by the act of 1861 is a radical change in the object of this corporation; it is an enterprise entirely different from that in the charter. That was to construct and operate a railroad from Hackensack to the Paterson railroad, at Boiling Spring, an easy and almost direct route to New York; it was from a thriving village, the county town of Bergen county, over a level country, and only five miles in length, as shown by the return of its location. The extension would be about twelve miles in length, through an uneven country, mostly, if not wholly, agricultural; with no village, except the very small one at New Bridge, on its route; and it runs into the state of New York some distance, and terminates at a point on that part of the Erie railway which the company have abandoned for regular traffic, and on which few trains are run. It is an entirely different enterprise.

The question here is, can this company, either with or without the consent of a majority in interest, of its stockholders, compel the complainant to embark capital subscribed for the first enterprise, in this new one, entirely different.

Since the Dartmouth College case, in the Supreme Court of the United States, the doctrine has been considered firmly established, and been confirmed by repeated decisions, both in that court and the state courts, that a charter, granted by the legislature to a corporation, is a contract between the state and the corporators, and that the state can pass no act to take away or impair any of the franchises or privileges granted by it. The company, or artificial person thus created, and its property, is subject to all general laws and police regulations made by the legislature after such grant, in the same manner as natural persons and their property are; provided they are not such as to take away or impair any of the franchises plainly granted by the charter. This doctrine did not prevent the legislature from conferring new privileges upon any corporation, to be accepted at its own election.

It is also settled, upon the principles of the common law, in this state, and most of the states of the Union, that when a number of persons associate themselves as partners, for a business and time specified in the agreement between them, or become members of a corporation for definite purposes and objects specified in their charter, which in such case is their contract, and for a time settled by it, that the objects and business of the partnership or corporation can not be

changed, or abandoned, or sold out, within the time specified, without the consent of all the partners or corporators; one partner or corporator, however small his interest, can prevent it. And this is so, although by law a majority in either case can control or manage the business against the will and interest of the minority, so long as it is within the scope of the partnership or charter.

This rule is founded on principle, the great principle of protecting every man and his property by contracts entered into, a guiding principle in all right legislation, and incorporated into the constitution of the United States, and of almost every state in the union. And the rule is not changed because the new business or enterprise proposed is allowed by law, or has been made lawful since the association was formed.

The leading case on this subject is that of *Natusch v. Irving*, decided by Lord Eldon, in 1824. It is not contained in the regular reports, but may be found in the appendix to *Gow on Partnership* (3d ed.) 576, or in *Lindley on Partnership*, p. 511. There, a partnership was formed for life insurance, and after it was entered into, an act of parliament made it lawful for such a firm to enter upon the business of marine insurance, which was prohibited to them before. A majority of the partners determined to embark in the business of marine insurance, thus made lawful. Lord Eldon held them barred by the contract of co-partnership, unless every partner agreed to alter it. In England, the same doctrine is applied to corporations rigidly, and is acknowledged in all cases on the subject. And although, from the omnipotent power of parliament, restrained by no written constitution, they hold that the contract can be changed by act of parliament, yet the English court of chancery will enjoin the directors or the corporation, on application of a single stockholder, from using the common funds to apply to parliament for a change.

The doctrine of *Natusch v. Irving* was adopted in New York by Chancellor Kent, in the case of *Livingston v. Lynch*, 4 Johns. C. R. 573, and in this state, by the decision of Parker, master, sitting to advise the chancellor, in *Kean v. Johnson*, 1 Stockt. 401, and has been recognized and adopted in almost all the states of the Union.

The opinion of Chancellor Bennet, in *Stevens v. The Rutland and Burlington R. Co.*, 29 Vt. 545 (also found in 1 Am. Law Reg. 154), contains a very able exposition and application of it. It will also be found in *Ang. & Ames on Corp.*, sections 391-3 and sections 536-9; *Lindley on Part.*, 515; *Pierce on Railways*, 78; *Hart. & N. H. R. Co. v. Crosswell*, 5 Hill 383; *Troy and Rutland R. Co. v. Kerr*, 17 Barb. 581; *Macedon Plank Road Co. v. Lapham*, 18 Barb. 312; *Buff., Corn. & N. Y. R. Co. v. Pottle*, 23 Barb. 21; *Banet v. The Alton and Sangamon R. Co.*, 13 Ill. 504; *Graham v. Birkenhead R. Co.*, 2 McN. & G., 156.

After the effect of the rule established in the *Dartmouth College* case began to be felt in the states, it was found that by the numerous acts of incorporation, freely and perhaps necessarily granted, great inconveniences resulted, and that provisions incautiously inserted, too



much restricted the power of future legislatures; and that the laws, which experience showed were necessary to govern corporations in the exercise of their powers, could not be passed. And the legislature of many states, by degrees and successively, adopted the practice of inserting in acts granting franchises, that they might alter, modify, or repeal the act; and also, by general law, provided that all acts of incorporation, thereafter passed, should be subject to such alteration and repeal.

The provision is contained in the general act of this state, passed in 1846 (Nix Dig. 152, section 6), that such charters should be subject to alteration, suspension, and repeal, in the discretion of the legislature. This and all similar special and general provisions were intended for the purpose specified; to give to the legislature the clear right, at their pleasure, to alter or repeal the acts of incorporation. The state, without this, could have done it with the assent of the corporators. They could give them property; they could add to their powers or privileges. But they could not take away any power, privilege, or franchise, conferred by the act, nor compel them to exercise any new power or franchise conferred.

Besides this general law of the state, the charter of the defendants contains this provision, that "the legislature may, at any time, alter, modify, or repeal the same."

The object and purpose of these provisions are so plain, and so plainly expressed in the words, that it seems strange that any doubt could be raised concerning it. It was a reservation to the state, for the benefit of the public, to be exercised by the state only. The state was making what had been decided to be a contract, and it reserved the power of change, by altering, modifying, or repealing the contract. Neither the words nor the circumstances, nor apparent objects for which this provision was made, can, by any fair construction, extend it to giving a power to one part of the corporators as against the other, which they did not have before.

It was to avoid the rule in the Dartmouth College case, not that in *Natusch v. Irving*, that the change was made. The words limit the power to that object.

On general principles, and the settled rules of construction, I would hold this to be the effect, and only effect, of the provision in the general act and in the charter of the defendants, without any hesitation, were it not for a series of decisions by most respectable courts, which hold that this provision obviates the effect of the rule in *Natusch v. Irving*, and *Kean v. Johnson*, and enables a majority of the corporators in all charters subject to a like provision, to change, by legislative permission, and within certain limits, the object and purpose of the corporation. They hold that the contract between associate corporators, that they will confine their business to life insurance, is changed by legislative permission to engage in marine insurance, or a contract to join in constructing a railroad from New York to Newark, can be changed to one from New York to Elizabeth by legislative consent. The reasoning is founded on the fact that the



subscription for the stock, which is the contract, was made, as in this case, under a charter which authorizes a road from the Paterson road to Hackensack, and authorizes the legislature to alter and modify the act. And from this they infer that it is a contract to join in building any road that the legislature may, by such alteration, authorize the company to build; and that such authority, or additional privilege, may be accepted by a majority of the corporators.

So far as the alteration is made by the legislature, in a way to be compulsory on the corporation, this is correct; as, if they should require the company to build a double track, or widen the draws in a bridge, or exact less fare or toll; these would be within the contract, or would be annexed to it as a condition, and every stockholder would take his stock subject to the contingency of such alteration.

But if the change in the act is simply offering the corporation the privilege of entering upon another and a different enterprise, it is not within the condition to the subscription. The only construction to be given is, that the legislature may alter, not that the stockholders may, as between each other. The case of *Natusch v. Irving* was decided upon this very ground. The act of parliament had given the company *the power* to embark in marine insurance, but the consent of all the parties was still held necessary. The plain object of the reservation in this case was to give the legislature, not a bare majority of the stockholders, power.

This view of the case is so clear upon principle that I feel constrained to be guided by it, although the weight of the decisions in other states is against it. \* \* \*

[After reviewing many cases from Maine, New York, Massachusetts, Illinois and Missouri, including *Buffalo, etc., Co. v. Dudley*, 14 N. Y. 336, *supra*, p. 1461, and *Durfee v. Old Colony, etc., R.*, 5 Allen 230, *supra*, p. 1462.]

But the principle on which they are decided is wrong, and if it is once conceded that a majority of the corporators may, by authority from the legislature, change the object of the enterprise in small things, there is no principle of law by which they can be restrained in any a little larger, or in the character of the whole work. The same principle will lead the courts of Illinois and Missouri, as it did those in New York, to allow radical changes, and must, if consistently applied, allow a charter for a railroad to be used for banking or insurance business, or for a canal, theater, brewery, or beer saloon.

There is no other alternative to the proposition, that while the power reserved authorizes the legislature, within certain limits, to make such alterations as they choose to impose, it gives no authority, when the legislature does not impose them, for the majority to adopt such alterations or enter upon such enterprises as are allowed by the legislature.

Again, the power of the legislature has its limits. It can repeal or suspend the charter; it can alter or modify it; it can take away the charter; but it can not impose a new one, and oblige the stockholders to accept it. It can alter or modify the old one; but power to alter

or modify anything can never be held to imply a power to substitute a thing entirely different. It is not the meaning of the words in their usually received sense. Power to alter a mansion-house would never be construed to mean a power to tear down all but the back kitchen and front piazza, and build one three times as large in its place. In anything altered, something must be preserved to keep up its identity; and a matter of the same kind, wholly or chiefly new, substituted for another, is not an alteration; it is a change.

In some cases there might be room for doubts, but in this case there can be no hesitation in saying that a railroad of seventeen miles from the Paterson road to Nanent, is a change and substitution of one work for another, and not an alteration of the road to Hackensack. They are substantially two different enterprises.

Again, the power is to alter or modify the act, and the true construction of this I hold to be, an alteration of something contained in or granted by the act. Any of the franchises granted may be altered; the right to take land by condemnation, the right to take tolls or fare, or the amount to be taken. But the legislature had no right to impose upon the company any other duty, or anything involving any other duty, than that attending the building a railroad from the Paterson road to Hackensack; anything in the manner of doing that they had a right to change. They could not oblige it to dam and drain all the meadows along the Hackensack, or to construct a canal, or to build a road from Hoboken to Newark, nor could they oblige it to extend its road to Nanent. They could as well oblige it to run to the Pacific. We must keep in mind that by the decisions in New Jersey the company need not accept the alterations; they are bound by them without acceptance if within the power reserved.

By a wider construction of this power any of the main lines of railroad running through the state, incorporated since 1846, or by an act which has in it the power of alteration, may be compelled to build and run a branch to any village or place near that route that the legislature may direct. It must be held that the power to alter and modify does not give power to make any substantial additions to the work.

Again, the act of 1861 does not, in fact, alter or modify the act of 1856 in any one thing embraced in it. That act, and every power and franchise granted by it, and any duty it imposed, remains the same. And the defendants can now go on under it precisely as if the supplement had not been passed. The company is authorized to construct another road; it is not compelled to do it. If it builds it, or if it does not, its old charter remains with all its franchises and privileges intact, and no new burthens imposed, except so far as it assumes them. This is in no sense of the word an alteration of the charter. It would be as absurd to say that an owner had *altered* his house, who had built a larger one on an adjoining lot. And until the legislature have made a valid alteration of the charter, the rights of each stockholder are as held in *Kean v. Johnson*; he can prevent all the others from changing or abandoning the work.

The supplement of 1861 is a perfectly valid and constitutional act.

It is a grant of privileges that the legislature have a right to grant, as they could grant to this corporation the right to conduct banking or insurance business, or to run a ferry across the North river; but the company is restrained, by the law of corporations and partnerships, from expending the money or using the credit of the corporation in such enterprises, unless every shareholder consents. \* \* \*

*Injunction allowed.*

**Note.** Amendment of corporate charters under the reserved power to alter or amend.

1. *In general:* In the *absence of a reserved power* to amend, the state may tender, but can not require the acceptance of, an amendment,—nor annul the charter for non-acceptance: 1819, Trustees of Dartmouth College v. Woodward, 4 Wheat. 518, *supra*, p. 708; but to make an amendment effective, when so tendered, there must be an acceptance (see cases *supra*, § 465); and if duly accepted it then becomes a part of the corporate charter (1892, Jackson v. Walsh, 75 Md. 304, *supra*, § 1447; 1829, Ehrenzeller v. Union Canal Co., 1 Rawle (Pa.) 181; 1898, Phinney v. Trustees, etc., 88 Md. 633, 42 Atl. 58). A material amendment requires the acceptance of all the members if there is no reserved power to amend: 1851, Stevens v. Rutland & B. R., 29 Vt. 545, *supra*, § 1448; but an immaterial amendment, perhaps, could be accepted by a majority of the members: 1857, Sprague v. Illinois R., 19 Ill. 173. As to what is material, and what is not, courts differ greatly.

Under a *reserved power* to amend the state has the right to *tender a proper amendment*, and *require its acceptance*, or a *cessation of business for non-acceptance* by *quo warranto* proceedings: 1872, Yeaton v. Bank of Old Dominion, 21 Grattan (Va.) 593, *supra*, § 750; the difficulty here is to determine what is a *proper amendment*.

Mr. Justice Clifford, in 1872, Holyoke v. Lyman, 15 Wall. 500, on 519, says, in regard to the extent of the reserved power to amend: "Vested rights, it is conceded, can not be destroyed or impaired under such a reserved power, but it is clear that the power may be exercised, and to almost any extent, to carry into effect the original purposes of the grant, and to protect the rights of the public and of the corporators, or to promote the due administration of the affairs of the corporation." In the earlier case of 1872, Miller v. State, 15 Wall. 478, on 498, he uses substantially the same language, but says, also, "such a reservation, it is held, will not warrant the legislature in passing laws to change the control of an institution from one religious sect to another, or to divert the fund of the donors to any new use inconsistent with the intent and purpose of the charter, or compel subscribers to the stock, whose subscription is conditional, to waive any of the conditions of the contract:" citing, 1869, State v. Adams, 44 Mo. 570; 1867, Zabriskie v. Railroad Co., 3 C. E. Green (18 N. J. Eq.) 178, *supra*, p. 1466; 1855, Oldtown & L. R. Co. v. Veazie, 39 Me. 571, on 581; 1854, Sage v. Dillard, 15 B. Mon. 340, on 357.

Of the extent of the reserved power, Chancellor Zabriskie, in Zabriskie v. Hackensack R. Co., 18 N. J. Eq. 178, *supra*, p. 1470, says: "The power to alter or modify anything can never be held to imply a power to substitute a thing entirely different. It is not the meaning of the words in their usually received sense. Power to alter a mansion-house would never be construed to mean a power to tear down all but the back kitchen and front piazza, and build one three times as large in its place. In anything altered, something must be preserved to keep up its identity; and a matter of the same kind wholly or chiefly new, substituted for another, is not an alteration; it is a change;"—this was said concerning an amendment authorizing the extension of a *five-mile* railroad, *twelve miles* farther.

In a somewhat similar way, Mr. Justice Swayne, in 1877, Shields v. Ohio, 95 U. S. 319, on 324, says: "The power of alteration and amendment is not without limit. The alterations must be reasonable; they must be made in good faith, and be consistent with the scope and object of the act of incorpora-

tion. Sheer oppression and wrong can not be inflicted under the guise of amendment or alteration. Beyond the sphere of the reserved powers, the vested rights of property of corporations, in such cases, are surrounded by the same sanctions and are as inviolable as in other cases,"—and then held that a change in the prescribed rate of fare that a corporation was allowed to charge was within the reserved power to amend. He cites *Miller v. N. Y. & E. R. Co.*, 21 Barb. (N. Y.) 513, holding that a railroad company could not be required to construct a crossing at its own expense, if of no special benefit to it,—a view that has since been abandoned: 1894, *N. Y. & N. E. R. Co. v. Bristol*, 151 U. S. 556.

Mr. Justice Gray, in 1900, *Looker v. Maynard*, 179 U. S. 56, adv. sh. Nov. 15, 1900, p. 21, on 23, thus states the rule: "The effect of such a provision, subject to which a charter is accepted, is, at least, to reserve to the legislature the power to make any alteration or amendment of a charter subject to it, which will not defeat or substantially impair the object of the grant, and which the legislature may deem necessary to carry into effect the purpose of the grant, or to protect the rights of the public or of the corporation, its stockholders, or creditors, or to promote the due administration of its affairs,"—and held an amendment valid authorizing cumulative voting, and affirming, 1897, *Attorney-Gen'l v. Looker*, 111 Mich. 498 (where the cases are collected), 56 L. R. A. 947.

Upon the other hand, Mr. Justice Brewer, in 1900, *Stearns v. Minnesota*, 179 U. S. 223, adv. sh. Jan. 1, 1901, p. 73, on 79, says: "That the power of amendment has its limitations, or rather that an amendment may not be wholly as to the right of the state, and absolutely ignoring the right of the other party, has been adjudged by this court in *Louisville Water Co. v. Clark*, 143 U. S. 1, 36 L. ed. 55, 12 Sup. Ct. 346. In that case it was held that while under a statute the water company had been exempted from taxation on condition that it supplied water free to the city of Louisville, an act withdrawing that exemption from taxation, although silent as to the corresponding obligation of the water company, must be construed as releasing it from an obligation based upon such exemption. So it may well be said in the case before us, that a contractual exemption of the property of the railroad company in whole, upon consideration of a certain payment, can not be changed by the state so as to continue the obligation in full, and at the same time deny to the company, either in whole or in part, the exemption conferred by the contract." In the subsequent case of 1900, *Duluth & I. R. R. Co. v. St. Louis*, 179 U. S. 302, Adv. Sh. Jan. 1, 1901, p. 124, on 125, involving the same question, Mr. Justice White says such an alteration or amendment is void because it is "a mere arbitrary exercise of power, giving rise, if enforced, not only to a denial of the equal protection of the laws, but to a deprivation of property without due process of law."

The question, however, is further complicated as to the matter of acceptance. Although, under the reserved power, the state, within the limits above mentioned, may tender, and require the acceptance of a material amendment, or a cessation of business, independent of the assent of the corporation (1872, *Yeaton v. Bank*, 21 Grattan 593, *supra*, p. 750; 1871, *Mayor of Worcester v. Norwich*, 109 Mass. 103); yet in order to make the amendment a part of the corporate constitution an acceptance is essential. Perhaps all cases agree that acquiescence and continuing to act after the amending act is passed is an acceptance (*Commonwealth v. Cullen*, 13 P. St. 133, *supra*, p. 417; *Bank of U. S. v. Dandridge*, 12 Wheat. 64, *supra*, p. 854); most cases further agree that an immaterial, beneficial amendment may be accepted by the majority so as to bind the minority, if there is a reserved power to amend (*Taggart v. Railroad Company*, 24 Md. 563,—change of name; *Banet v. Railway Co.*, 13 Ill. 504,—slight change in location of railroad).

But if the proposed amendment is *material* the courts do not agree as to whether a majority may accept so as to bind the minority or not; neither do they agree as to what is a material amendment. One line of authorities holds that, under the reserved power of the state to amend, whoever becomes a member of such corporation impliedly consents to be governed in this particular by the judgment of the majority as to whether a proposed amendment

shall be accepted, or whether the corporation shall quit business rather than accept. (See 1862, *Durfee v. Old Colony R. Co.*, 5 Allen (Mass.) 230, *supra*, p. 1462.)

Another line of authorities holds otherwise,—that each person when he becomes a member of a corporation, where the state reserves the right to amend, does not impliedly agree to submit the question of acceptance to the majority, but only agrees to exercise his own judgment as to whether the amendment should be accepted or not, and if he believes it should not be accepted, he can prevent its acceptance (*Zabriskie v. Hackensack R. Co.*, 18 N. J. Eq. 178; 1899, *Alexander v. Atlanta & W. P. R. Co.*, 108 Ga. 151, 33 S. E. Rep. 866; 1899, *In re Election of Directors of Newark L. Assn.*, 64 N. J. L. 217, 43 Atl. Rep. 435). I have found no case that has gone so far as to hold that a single member can prevent the acceptance of a material amendment (but one which the state under its reserve power within the limits above pointed out, could require either to be accepted, or a cessation of business), so as to require a cessation of business, if all the other members wished to continue. Mr. Beach, *Private Corporations*, section 42, forcibly says: "Neither a mandatory statute, nor a vote of the directors, nor of a majority of the stockholders can compel a dissenting stockholder to accept a material alteration of the terms of the contract in view of which he intrusted his funds to the corporate management,"—citing, 1852, *Winter v. Muscogee R. Co.*, 11 Ga. 438, holding a dissenting subscriber is released. In states holding this doctrine, the dissenting shareholder can enjoin the acceptance of an amendment that is beyond the power of the state to insist upon: 1855, *Dodge v. Woolsey*, 18 How. 331, *supra*, p. 88; 1861, *Owen v. Purdy*, 12 O. St. 73; 1868, *Monsey v. Ind. R. Co.*, 4 Biss. 78; or if within the power of the state, and material, and the member has not paid his subscription, he can refuse to do so: 1843, *Hartford & N. H. R. Co. v. Crosswell*, 5 Hill (N. Y.) 383; *Clearwater v. Meredith*, 1 Wall. 25, *supra*, p. 984; *Ashton v. Burbank*, 2 Dillon, 435, *supra*, p. 87; but if he has paid for his stock, and the amendment is material and within the power of the state to make, then it seems there is no logical escape from the conclusion that a single dissenting member can require the cessation and winding up of the corporate business against the wish of every other member, rather than acceptance of an amendment obnoxious, even though beneficial, to him. To meet this difficulty, it has been held that the dissenting shareholder must yield to the control by the majority if they offer to purchase his shares at the full market price: 1858, *Lauman v. Lebanon Valley R. Co.*, 30 Pa. St. 42, 72 Am. Dec. 685; such a view, however, even though expressly authorized by statute after one becomes a member, would seem to allow the forcible taking of a man's property without due process of law, and be wholly unjustifiable unless the corporation exercised such functions as would authorize the taking of *private property* for a public use by way of eminent domain. This doctrine, however, has not met with favor, in the courts, although some of the states provide by legislation for such cases, or expressly provide that a certain majority may accept material amendments. One who becomes a member after such a statutory provision ought to have no ground of complaint; 1904, *Wright v. Minnesota Mut. Lf. Ins. Co.*, 193 U. S. 657.

## 2. Illustrations:

Amendments under following circumstances have been held valid:

(a) *Directors*—changing the number or method of selection: 1871, *N. H. & D. R. Co. v. Chapman*, 38 Conn. 56; 1872, *Miller v. New York*, 15 Wall. 478; 1883, *Close v. Glenwood Cemetery*, 107 U. S. 466; 1892, *Jackson v. Walsh*, 75 Md. 304. *Contra*, 1899, *In re Election of Directors*, 64 N. J. L. 217, 43 Atl. Rep. 435. See *infra*, *Voting*.

(b) *Gas companies*, may add to their business electric light business: 1896, *State v. Taylor*, 55 O. St. 61; 1898, *Pickard v. Hughey*, 58 O. St. 577.

And a city can revoke an exclusive franchise to furnish gas to the city, and build a plant of its own: 1890, *State v. Hamilton*, 47 O. St. 52; 1892, *Hamilton G. L. Co. v. Hamilton*, 146 U. S. 258. Compare, 1899, *Danville v. Danville W. Co.*, 178 Ill. 299, 69 Am. St. Rep. 304.

(c) *Incorporation fees*, may be changed, even as to parties authorized to in-



corporate under foreclosure proceedings had before the change: 1893, *People v. Cook*, 148 U. S. 397.

(d) *Mill companies*, may be required to construct fishways through dams authorized, or provide locks for navigation purposes: 1849, *South Bay Meadow Dam Co. v. Gray*, 30 Me. 547; 1870, *Inland Fisheries v. Holyoke Water Co.*, 104 Mass. 446; 1872, *Holyoke Co. v. Lyman*, 15 Wall. 500. Compare, 1859, *Commonwealth v. Essex Co.*, 13 Gray (Mass.) 239.

(e) *Name*—may be changed: 1856, *Buffalo R. Co. v. Dudley*, 14 N. Y. 336; 1857, *Hyatt v. McMahon*, 25 Barb. 457; 1898, *Phinney v. Sheppard*, 88 Md. 633.

(f) *Railroads*—may be required to change *crossings*, grades, levels, surfaces, or stations at their own cost: 1850, *City of Roxbury v. Boston*, etc., R. Co., 6 Cush. 424; 1862, *Fitchburg R. Co. v. Grand Junc. R.*, 4 Allen (Mass.) 198; 1862, *Albany*, etc., R. Co. v. *Brownell*, 24 N. Y. 345; 1869, *Commonwealth v. Eastern R.*, 103 Mass. 254; 1871, *Mayor of Worcester v. Norwich R. Co.*, 109 Mass. 103; 1889, *Montclair v. N. Y.*, etc., R., 45 N. J. Eq. 436; 1894, *N. Y. & N. E. R. Co. v. Bristol*, 151 U. S. 556.

Or change location, before construction of line: 1890, *Macon*, etc., R. Co. v. *Gibson*, 85 Ga. 1; 21 Am. St. Rep. 135; 1900, *Adirondack R. Co. v. New York*, 176 U. S. 335; compare, 1852, *Winter v. Muscogee R. Co.*, 11 Ga. 438.

Or extend the line: 1854, *Schenectady*, etc., *Plank R. v. Thatcher*, 11 N. Y. 102; 1856, *Buffalo R. Co. v. Dudley*, 14 N. Y. 336 (from 60 to 90 miles); 1858, *Illinois Riv. R. v. Zimmer*, 20 Ill. 654; 1879, *Cross v. Peach Bottom R. Co.*, 90 Pa. St. 392. But *contra*, 1867, *Zabriskie v. R. Co.*, 18 N. J. Eq. 178 (*supra*).

Or require employes to be paid in full when discharged, or at certain times: 1892, *State v. Brown*, 18 R. I. 16, 17 L. R. A. 856; 1894, *Leep v. Railway Co.*, 58 Ark. 407, 41 Am. St. Rep. 109, 23 L. R. A. 264; 1897, *St. Louis*, etc., R. Co. v. *Paul*, 64 Ark. 83, 62 Am. St. Rep. 154, 37 L. R. A. 504. *Contra*, 1893, *Braceville Coal Co. v. People*, 147 Ill. 66, 37 Am. St. Rep. 206.

Or pay for surveying lands granted: 1885, *Northern Pacific R. v. Thrall Co.*, 115 U. S. 600.

Or provide a sinking fund: 1878, *Sinking-Fund Cases*, 99 U. S. 700, *supra*, p. 1405.

(g) *Rates*, of quasi-public corporations may be changed, or the method of fixing them: 1872, *Parker v. Railroad Co.*, 109 Mass. 506; 1877, *Shields v. Ohio*, 95 U. S. 319; 1884, *Spring Valley W. W. v. Schottler*, 110 U. S. 347; 1888, *Buffalo*, etc., R. Co. v. *Buffalo*, 111 N. Y. 132, 2 L. R. A. 384; 1896, *Winchester*, etc., R. Co. v. *Croxton*, 98 Ky. 739, 33 L. R. A. 177; 1897, *Smith v. Railway Co.*, 114 Mich. 460; 1899, *Danville v. Danville W. Co.*, 178 Ill. 299, 69 Am. St. Rep. 304.

But railroad companies, under the reserved power to amend charters, can not be required to furnish mileage tickets, good on all roads: 1893, *Attorney-General v. Old Colony R.*, 160 Mass. 62; nor, after the state has fixed a maximum rate for the state, can companies be required to furnish 1,000-mile tickets for \$20 to a man and his family: 1899, *L. S. & M. S. R. Co. v. Smith*, 173 U. S. 684.

(h) *Stock*, increase: 1854, *Schnectady*, etc., *Plank Road v. Thatcher*, 11 N. Y. 102; 1856, *Buffalo*, etc., R. Co. v. *Dudley*, 14 N. Y. 336; 1873, *Covington v. Covington & C. B. Co.*, 10 Bush (Ky.) 69; or reduction: 1854, *Troy & Rutland R. v. Kerr*, 17 Barb. (N. Y.) 588; or issuing preferred: 1863, *Rutland & B. R. v. Thrall*, 35 Vt. 536.

(i) *Stockholders*, liability may be increased: 1857, *Hyatt v. McMahon*, 25 Barb. (N. Y.) 457; 1860, *In re Lee & Co.'s Bank*, 21 N. Y. 9; 1861, *Sherman v. Smith*, 1 Black (U. S.) 587; 1862, *Bailey v. Hollister*, 26 N. Y. 112; 1869, *Gardner v. Insurance Co.*, 9 R. I. 194; 1896, *McGowan v. McDonald*, 111 Cal. 57, 52 Am. St. Rep. 149; 1900, *Williams v. Nall*, 21 Ky. L. Rep. 1526, 55 S. W. Rep. 706; cf. 1883, *Consol. Assn. v. Lord*, 35 La. Ann. 425.

(j) *Taxation*—method of imposing may be changed: 1889, *Mayor*, etc., v. *Twenty-third St.*, etc., 113 N. Y. 311; or exemptions may be withdrawn: 1890, *Wagner's Institute's Appeal*, 132 Pa. 612, 19 Atl. 297; 1891, *Louisville Water*



Co. v. Clark, 143 U. S. 1; 1900, Stearns v. Minnesota, 179 U. S. 223, adv. sh. Jan. 15, 1901, p. 73; 1900, Duluth & I. R. Co. v. St. Louis, 179 U. S. 302, adv. sh. Jan. 15, 1901, p. 124.

(k) *Voting*—cumulative voting may be allowed: 1891, Cross v. Railway Co., 35 W. Va. 174; 1897, Attorney-General v. Looker, 111 Mich. 498 (Collecting Cases, p. 507); 1900, Looker v. Maynard, 179 U. S. 46, adv. sh. Nov. 15, 1900, p. 21. But see, *contra*: 1876, Hays v. Commonwealth, 82 Pa. St. 518; 1884, Orr v. Bracken, 81 Ky. 593; 1899, *In re Election of Directors, etc.*, 64 N. J. L. 217, 43 Atl. 435.

(l) *Miscellaneous*: See, also, 1828, McLaren v. Pennington, 1 Paige Ch. (N. Y.) 102; 1855, Mass. Gen. Hosp. v. State Mut. L. A. Co., 4 Gray (Mass.) 227; 1866, Taggart v. Western R. Co., 24 Md. 563; 1871, Pennsylvania College Cases, 13 Wall. 191; 1875, Ross v. Chicago, etc., R. Co., 77 Ill. 127; 1892, Miller v. Insurance Co., 92 Tenn. 167; 1893, Virginia Devel. Co. v. Crozer Iron Co., 90 Va. 126, 44 Am. St. Rep. 893; 1900, Wilmington City R. Co. v. Wilmington, — Del. Ch. —, 46 Atl. Rep. 12.

Under reserved power to amend, the following amendments have been held invalid: 1859, Commonwealth v. Essex Bank, 13 Gray (Mass.) 239 (requiring a fishway through a dam to be enlarged after full damages done to the rights of fishing had been paid); 1867, Zabriskie v. Hackensack R., 18 N. J. Eq. 178 (extending a five-mile railroad to 17 miles); 1875, Lothrop v. Stedman, 42 Conn. 583 (preventing distribution of assets among those entitled); 1878, Ashuelot R. Co. v. Elliot, 58 N. H. 451 (taking away the right to redeem a mortgage); 1880, City of Detroit v. Detroit & H. P. R. Co., 43 Mich. 140 (requiring the abandonment of two miles of toll-paying road); 1883, Consol. Assn. v. Lord, 35 La. Ann. 425 (changing shareholder's liability without his consent—but as to this see *supra* (i)); 1884, Orr v. Bracken, 81 Ky. 593 (allowing cumulative voting—but see *supra* (k)); 1893, Braceville Coal Co. v. People, 147 Ill. 66, 37 Am. St. Rep. 206 (requiring railroads to pay employes at specified times—but see *supra* (f)); 1894, Leep v. Railway Co., 58 Ark. 407, 41 Am. St. Rep. 109, 23 L. R. A. 264 (forbidding corporations from contracting); 1900, Stearns v. Minnesota, 179 U. S. 223, adv. sh. January 15, 1901, p. 21 (repealing or changing a tax exemption, but continuing the obligation of the company, which was the consideration for the exemption).

### SUBDIVISION III. THE STATE AND NATIONAL CORPORATIONS.

#### Sec. 474. Status of National Corporation within the States.

#### COMMONWEALTH v. TEXAS AND PACIFIC RAILROAD COMPANY.

1881. IN THE SUPREME COURT OF PENNSYLVANIA. 98 Pa. St. Rep. 90-101.

MR. JUSTICE STERRETT: The 16th section of the revenue act of June 7, 1879, provides that no foreign corporation, except foreign insurance companies, etc., shall have an office in this commonwealth for the use of its officers, stockholders, agents or employes, without first having obtained from the auditor-general a license to do so; for which license every such corporation shall pay "annually one-fourth of a mill on each dollar of the capital stock which said company is authorized to have." \* \* \* "Provided, That no license shall be necessary for any corporation paying a tax under any previous section

of this act, or whose capital stock, or a majority thereof, is owned or controlled by a corporation of this state which does pay a tax under any previous section of this act." \* \* \*

It is admitted that the defendant company was incorporated by act of congress for the purpose of constructing and operating a railroad from a point in the state of Texas to San Diego, California, with an authorized capital, not exceeding \$50,000,000, less than one-sixth of which was issued, and that the company has not invested or used its capital in this commonwealth, except in the purchase of rails and other railroad materials and supplies; but, during the year ending July 1, 1880, it kept and maintained for the use of its officers, stockholders, agents and employes in the transaction of their business, an office in the city of Philadelphia, without having obtained a license from the auditor-general. The company having thus failed to procure a license, the auditor-general and state treasurer, in pursuance of the provisions of the act, settled an account against it for \$12,500, with interest from October 21, 1880. From this settlement an appeal was taken by the company, and the court of common pleas, in a clear and able opinion, held that it was not liable, for the reasons that it is not a foreign corporation, within the meaning of the act, and that nearly all its capital stock actually issued was held and controlled by the California and Texas Construction Company, a corporation of this state, which was liable to pay, and did pay, a tax under a previous section of the act, and hence the defendant was within the protection of the proviso above quoted. These are controlling points in the case, and if either of them be correct the judgment must be affirmed.

The general government, in its relation to that of the several states, can not be considered a foreign government in the ordinary acceptance of that term. Within the sphere of its delegated powers its authority extends over all the states of which it is composed, and to that extent it may be said to be identified with the government of each. Hence, a corporation created by the government of the United States can not with propriety be called a foreign corporation. It is contended, however, that in a more comprehensive sense all corporations not created directly by state authority may be classed as foreign, in contradistinction to those of exclusively state origin; and that such was intended to be the meaning of the word "foreign," as used in the act. This might be so if there was anything in the act itself indicative of an intent to use the word in that sense; but there is not. On the contrary, in the fifth section, which imposes a tax on limited partnerships, etc., they are described as "partnerships organized under or pursuant to the laws of this state, or of any other state or territory, or of the United States, or under the laws of any foreign state, kingdom or government;" thus clearly showing that when the legislature intended to tax associations created by the general government they used apt words of description for that purpose. The same distinction is observed in other portions of the act, especially in the sixth section. The construction adopted by the learned president of the

common pleas is so fully sustained, on principle as well as authority, that it is unnecessary to add anything to what is so well said in his opinion. \* \* \*

*Affirmed.*

*Note.* See: 1819, *McCulloch v. Maryland*, 4 Wheat. 316; 1824, *Osborn v. Bank of United States*, 9 Wheat. 738; 1869, *National Bank v. Commonwealth*, 9 Wall. 353; 1869, *Crocker v. Marine National Bank*, 101 Mass. 240, 3 Am. Rep. 336; 1873, *Tiffany v. National Bank of Missouri*, 18 Wall. 400; 1875, *Farmers' & M. Bank v. Dearing*, 91 U. S. 29; 1876, *First Nat'l Bank v. Hubbard*, 49 Vt. 1, 24 Am. Rep. 97; 1878, *Bletz v. Columbia National Bank*, 87 Pa. St. 87, 30 Am. Rep. 343; 1880, *Robinson v. National Bank of Newberne*, 81 N. Y. 385, 37 Am. Rep. 508; 1881, *Telegraph Co. v. Texas*, 105 U. S. 460, *infra*, p. 1397; 1881, *Rosenblatt v. Johnston*, 104 U. S. 462; 1887, *California v. Pacific R. Co.*, 127 U. S. 1; 1894, *Luxton v. North River Bridge Co.*, 153 U. S. 525, *supra*, section 65, note, p. 324; 1899, *Daggs v. Phoenix National Bank*, 177 U. S. 549; 1899, *Beckham v. Hague*, 44 App. Div. (N. Y.) 146.

## Sec. 475. Same.

MR. JUSTICE BRADLEY IN CALIFORNIA V. PACIFIC RAILROAD COMPANY.<sup>1</sup>

1887. IN THE SUPREME COURT OF THE UNITED STATES. 127 U. S. Rep. 1, on 40-42.

[The State Board of Equalization, in assessing the property of the Central Pacific Railroad in the state of California, included all the franchises of the company exercised in the state. The company was incorporated in California with power to build and operate a railroad from the Pacific ocean to the east line of the state, and there connect with a proposed line to the Missouri river; this proposed line was soon afterward authorized to be built from the Missouri river to the Pacific ocean, by the Union Pacific Company, incorporated by congress, and given various franchises and privileges. Afterward, in order to facilitate the construction of the through road, congress authorized the Central Company to build part of the line, beginning at the Pacific ocean and extend eastward until it met the line of the Union Company, and conferred upon the former all the rights and privileges of the latter. The through line was completed, by the Union Company from the Missouri river westward, and by the Central Company from the Pacific ocean eastward, to Ogden, Utah, where connection was made. After holding the rights and privileges conferred by congress upon the Central Company were within its constitutional power, the opinion continues:]

Assuming, then, that the Central Pacific Railroad Company has received the important franchises referred to by grant of the United States, the question arises whether they are legitimate subjects of taxation by the state. They were granted to the company for national

<sup>1</sup> Statement abridged; and only that part of opinion relating to the one point given.

purposes and to subserve national ends. It seems very clear that the state of California can neither take them away, nor destroy nor abridge them, nor cripple them by onerous burdens. Can it tax them? It may undoubtedly tax outside visible property of the company, situated within the state. That is a different thing. But may it tax franchises which are the grant of the United States? In our judgment it can not. What is a franchise? Under the English law Blackstone defines it as "a royal privilege, or branch of the king's prerogative, subsisting in the hands of a subject." 2 Bl. Com. 37. Generalized, and divested of the special form which it assumes under a monarchical government based on feudal traditions, a franchise is a right, privilege or power of public concern, which ought not to be exercised by private individuals at their mere will and pleasure, but should be reserved for public control and administration, either by the government directly, or by public agents, acting under such conditions and regulations as the government may impose in the public interest, and for the public security. Such rights and powers must exist under every form of society. They are always educed by the laws and customs of the community. Under our system, their existence and disposal are under the control of the legislative department of the government, and they can not be assumed or exercised without legislative authority. No private person can establish a public highway, or a public ferry, or railroad, or charge tolls for the use of the same, without authority from the legislature, direct or derived. These are franchises. No private person can take another's property, even for a public use, without such authority; which is the same as to say, that the right of eminent domain can only be exercised by virtue of a legislative grant. This is a franchise. No persons can make themselves a body corporate and politic without legislative authority. Corporate capacity is a franchise. The list might be continued indefinitely.

In view of this description of the nature of a franchise, how can it be possible that a franchise granted by congress can be subject to taxation by a state without the consent of congress? Taxation is a burden, and may be laid so heavily as to destroy the thing taxed, or render it valueless. As Chief Justice Marshall said in *McCulloch v. Maryland*, "the power to tax involves the power to destroy." Recollecting the fundamental principle that the constitution, laws and treaties of the United States are the supreme law of the land, it seems to us almost absurd to contend that a power given to a person or corporation by the United States may be subject to taxation by a state. The power conferred emanates from, and is a portion of, the power of the government that confers it. To tax it, is not only derogatory to the dignity, but subversive of the powers of the government, and repugnant to its paramount sovereignty. It is unnecessary to cite cases on this subject. The principles laid down by this court in *McCulloch v. Maryland*, 4 Wheat. 316; *Osborn v. The Bank of the United States*, 9 Wheat. 738; and *Brown v. Maryland*, 12 Wheat. 419, and in numerous cases since which have followed in their lead, abundantly sus-

tain the views we have expressed. It may be added that these views are not in conflict with the decisions of this court in *Thomson v. Pacific Railroad*, 9 Wall. 579, and *Railroad Co. v. Peniston*, 18 Wall. 5. As explained in the opinion of the court in the latter case, the tax there was upon the property of the company, and not upon its franchises or operations. 18 Wall. 35, 37.

The taxation of a corporate franchise merely as such, unless pursuant to a stipulation in the original charter of the company, is the exercise of an authority somewhat arbitrary in its character. It has no limitation but the discretion of the taxing power. The value of the franchise is not measured like that of property, but may be ten thousand or ten hundred thousand dollars, as the legislature may choose. Or, without any valuation of the franchise at all, the tax may be arbitrarily laid. It is not an idle objection, therefore, made by the company against the tax imposed in the present cases.

*Note.* See, 1896, *Central Pac. R. Co. v. California*, 162 U. S. 91. Also note preceding case, and 1894, *Luxton v. North River Bridge Co.*, 153 U. S. 525, *supra*, § 65, and note, pp. 324, 1388.

#### SUBDIVISION IV. THE STATE AND FOREIGN CORPORATIONS.

##### ARTICLE I. RIGHTS OF FOREIGN CORPORATIONS.

#### Sec. 476. (1) Protection of its property.

See *Manchester Fire Ins. Co. v. Herriott*, 91 Fed. Rep. 711, *infra*, p. 1498; *Blake v. McClung*, 172 U. S. 239, *infra*, p. 2036.

*Note.* 1896, *United States v. N. W. Ex. Co.*, 164 U. S. 686; 1898, *Hammond Beef, etc., Co. v. Best*, 91 Me. 431, 42 L. R. A. 528; 1898, *Bergner & Engel B. Co. v. Dreyfus*, 172 Mass. 154, 70 Am. St. Rep. 251; 1899, *Orient Ins. Co. v. Daggs*, 172 U. S. 557; 1899, *Johnson v. Goodyear Min. Co.*, 127 Cal. 4, 47 L. R. A. 338; 1900, *Blake v. McClung*, 176 U. S. 59, *infra*, p. 2045.

#### Sec. 477. (2) To do business out of the state creating it. Doctrine of comity.

##### BANK OF AUGUSTA v. EARLE.<sup>1</sup>

1839. IN THE SUPREME COURT OF THE UNITED STATES. 13 Pet. (38 U. S.) 519-606.

Error to Circuit Court for southern district of Alabama.

MR. CHIEF JUSTICE TANEY: \* \* \* The questions presented to the court arise upon a case stated in the circuit court in the follow-

<sup>1</sup>Arguments, part of opinion of Taney, C. J., and all of opinion of McKinley, J., dissenting, omitted.

ing words: "The defendant defends this action upon the following facts, that are admitted by the plaintiffs: that plaintiffs are a corporation incorporated by an act of the legislature of the state of Georgia, and have powers usually conferred upon banking institutions, such as to purchase bills of exchange, etc. That the bill sued on was made and indorsed, for the purpose of being discounted by Thomas McGran, the agent of said bank, who had funds of the plaintiffs in his hands, for the purpose of purchasing bills, which funds were derived from bills and notes discounted in Georgia by said plaintiffs, and payable in Mobile; and the said McGran, agent as aforesaid, did so discount and purchase the said bill sued on, in the city of Mobile, state aforesaid, for the benefit of said bank, and with their funds, and to remit said funds to the said plaintiffs. If the court shall say, that the facts constitute a defense to this action, judgment will be given for the defendant, otherwise for plaintiffs, for the amount of the bill, damages, interest and costs; either party to have the right of appeal or writ of error to the supreme court, upon this statement of facts, and the judgment thereon."

Upon this statement of facts the court gave judgment for the defendant, being of opinion that a bank incorporated by the laws of Georgia, with a power, among other things, to purchase bills of exchange, could not lawfully exercise that power in the state of Alabama; and that the contract for this bill was, therefore, void, and did not bind the parties to the payment of the money. \* \* \*

*It may be safely assumed that a corporation can make no contracts and do no acts, either within or without the state which creates it, except such as are authorized by its charter; and those acts must also be done by such officers or agents, and in such manner as the charter authorizes.* And if the law creating a corporation does not, by the true construction of the words used in the charter, give it the right to exercise its powers beyond the limits of the state, all contracts made by it in other states would be void.

The charter of the bank of Augusta authorizes it, in general terms, to deal in bills of exchange; and consequently, gives it the power to purchase foreign bills as well as inland; in other words, to purchase bills payable in another state. The power thus given clothed the corporation with the right to make contracts out of the state, in so far as Georgia could confer it. For whenever it purchased a foreign bill, and forwarded it to an agent to present for acceptance, if it was honored by the drawee, the contract of acceptance was necessarily made in another state; and the general power to purchase bills, without any restriction as to place, by its fair and natural import authorized the bank to make such purchases, wherever it was found most convenient and profitable to the institution, and also to employ suitable agents for that purpose. The purchase of the bill in question was, therefore, the exercise of one of the powers which the bank possessed under its charter, and was sanctioned by the law of Georgia creating the corporation, so far as that state could authorize a corporation to exercise its power beyond the limits of its own jurisdiction.



But it has been urged in the argument that, notwithstanding the powers thus conferred by the terms of the charter, a corporation, from the very nature of its being, can have no authority to contract out of the limits of the state; that the laws of a state can have no extra-territorial operation; and that, as a corporation is the mere creature of a law of the state, it can have no existence beyond the limits in which that law operates; and that it must necessarily be incapable of making a contract in another place. *It is very true that a corporation can have no legal existence out of the boundaries of the sovereignty by which it is created. It exists only in contemplation of law, and by force of the law; and where that law ceases to operate, and is no longer obligatory, the corporation can have no existence. It must dwell in the place of its creation, and can not migrate to another sovereignty.* But although it must live and have its being in that state only, yet it does not by any means follow that its existence there will not be recognized in other places; and its residence in one state creates no insuperable objection to its power of contracting in another. It is, indeed, a mere artificial being, invisible and intangible; yet it is a person, for certain purposes, in contemplation of law, and has been recognized as such by the decisions of this court. It was so held in the case of the United States v. Amedy, 11 Wheat. 412, and in Beaston v. Farmers' Bank of Delaware, 12 Pet. 125. Now, natural persons, through the intervention of agents, are continually making contracts in countries in which they do not reside; and where they are not personally present when the contract is made; and nobody has ever doubted the validity of these agreements. And what greater objection can there be to the capacity of an artificial person, by its agents, to make a contract, within the scope of its limited powers, in a sovereignty in which it does not reside, provided such contracts are permitted to be made by them by the laws of the place.

The corporation must, no doubt, show that the law of its creation gave it authority to make such contracts through such agents. *Yet, as in the case of a natural person, it is not necessary that it should actually exist in the sovereignty in which the contract is made. It is sufficient that its existence as an artificial person, in the state of its creation, is acknowledged and recognized by the law of the nation where the dealing takes place; and that it is permitted by the laws of that place to exercise there the powers with which it is endowed.*

*Every power, however, of the description of which we are speaking, which a corporation exercises in another state, depends for its validity upon the laws of the sovereignty in which it is exercised; and a corporation can make no valid contract without their sanction, express or implied. And this brings us to the question which has been so elaborately discussed; whether, by the comity of nations, and between these states, the corporations of one state are permitted to make contracts in another. It is needless to enumerate here the instances in which, by the general practice of civilized countries, the laws of one will, by the comity of nations, be recognized and*

executed in another, where the rights of individuals are concerned. The cases of contracts made in a foreign country are familiar examples; and courts of justice have always expounded and executed them, according to the laws of the place in which they were made, provided the law was not repugnant to the laws or policy of their own country. The comity thus extended to other nations is no impeachment of sovereignty. It is the voluntary act of the nation by which it is offered; and is inadmissible, when contrary to its policy, or prejudicial to its interests. But it contributes so largely to promote justice between individuals, and to produce a friendly intercourse between the sovereignties to which they belong, that courts of justice have continually acted upon it as a part of the voluntary law of nations. It is truly said in Story's Conflict of Laws, 37, that, in the silence of any positive rule, affirming or denying or restraining the operation of foreign laws, courts of justice presume the tacit adoption of them by their own government, unless they are repugnant to its policy, or prejudicial to its interests. It is not the comity of the courts, but the comity of the nation, which is administered and ascertained in the same way, and guided by the same reasoning by which all other principles of municipal law are ascertained and guided.

Adopting, as we do, the principle here stated, we proceed to inquire, whether, by the comity of nations, foreign corporations are permitted to make contracts within their jurisdiction, and we can perceive no sufficient reason for excluding them, when they are not contrary to the known policy of the state or injurious to its interests. It is nothing more than the admission of the existence of an artificial person, created by the law of another state, and clothed with the power of making certain contracts; it is but the usual comity of recognizing the law of another state. In England, from which we have received our general principles of jurisprudence, no doubt appears to have been entertained of the right of a foreign corporation to sue in its courts, since the case of *Henriquez v. Dutch West India Company*, decided in 1729. 2 Ld. Raym. 1532. And it is a matter of history, which this court is bound to notice, that corporations, created in this country, have been in the open practice, for many years past, of making contracts in England, of various kinds, and to very large amounts; and we have never seen a doubt suggested there of the validity of these contracts by any court or any jurist. It is impossible to imagine that any court in the United States would refuse to execute a contract by which an American corporation had borrowed money in England; yet if the contracts of corporations made out of the state in which they are created, are void, even contracts of that description could not be enforced.

It has, however, been supposed that the rules of comity between foreign nations do not apply to the states of this Union; that they extend to one another no other rights than those which are given by the constitution of the United States, and that the courts of the general government are not at liberty to presume, in the absence of all legislation on the subject, that a state has adopted the comity of nations

towards the other states, as a part of its jurisprudence; or that it acknowledges any rights but those which are secured by the constitution of the United States. The court think otherwise. The intimate union of these states as members of the same great political family; the deep and vital interests which bind them so closely together should lead us, in the absence of proof to the contrary, to presume a greater degree of comity and friendship and kindness toward one another than we should be authorized to presume between foreign nations. And when (as without doubt must occasionally happen) the interest or policy of any state requires it to restrict the rule, it has but to declare its will and the legal presumption is at once at an end. But until this is done, upon what grounds could this court refuse to administer the law of international comity between these states? They are sovereign states, and the history of the past and the events which are daily occurring furnish the strongest evidence that they have adopted toward each other the laws of comity in their fullest extent. Money is frequently borrowed in one state by a corporation created in another. The numerous banks established by different states are in the constant habit of contracting and dealing with one another. Agencies for corporations engaged in the business of insurance and of banking have been established in other states, and suffered to make contracts without any objection on the part of the state authorities. These usages of commerce and trade have been so general and public, and have been practiced for so long a period of time and so generally acquiesced in by the states that the court can not overlook them when a question like the one before us is under consideration. The silence of the state authorities while these events are passing before them, shows their assent to the ordinary laws of comity, which permit a corporation to make contracts in another state. But we are not left to infer it merely from the general usages of trade and the silent acquiescence of the states. It appears from the cases cited in the argument, which it is unnecessary to recapitulate in this opinion, that it has been decided in many of the state courts, we believe in all of them where the question has arisen, that a corporation of one state may sue in the courts of another. If it may sue why may it not make a contract? The right to sue is one of the powers which it derives from its charter. If the courts of another country take notice of its existence as a corporation, so far as to allow it to maintain a suit and permit it to exercise that power, why should not its existence be recognized for other purposes, and the corporation permitted to exercise another power which is given to it by the same law and the same sovereignty—where the last mentioned power does not come in conflict with the interest or policy of the state? There is certainly nothing in the nature and character of a corporation which could justly lead to such a distinction, and which should extend to it the comity of suit and refuse to it the comity of contract. If it is allowed to sue it would, of course, be permitted to compromise, if it thought proper, with its debtor; to give him time; to accept something else in satisfaction; to give him a release; and to employ an attorney for itself to conduct the suit. These are

all matters of contract, and yet are so intimately connected with the right to sue, that the latter could not be effectually exercised if the former were denied. \* \* \*

But it can not be necessary to pursue the argument further. We think it is well settled that by the law of comity among nations a corporation created by one sovereignty is permitted to make contracts in another, and to sue in its courts, and that the same law of comity prevails among the several sovereignties of this union. The public, and well-known and long-continued usages of trade; the general acquiescence of the states; the particular legislation of some of them, as well as the legislation of congress, all concur in proving the truth of this proposition.

But we have already said that this comity is presumed from the silent acquiescence of the state. Whenever a state sufficiently indicates that contracts which derive their validity from its comity are repugnant to its policy, or are considered as injurious to its interests, the presumption in favor of its adoption can no longer be made. \* \* \*

The question then recurs: Does the policy of Alabama deny to the corporations of other states the ordinary comity between nations, or does it permit such a corporation to make those contracts which from their nature and subject-matter, are consistent with its policy, and are allowed to individuals? In making such contracts, a corporation, no doubt, exercises its corporate franchise. But it must do this whenever it acts as a corporation, for its existence is a franchise. Now, it has been held in the courts of Alabama itself, 2 Stew. 147, that the corporations of another state may sue in its courts; and the decision is put directly on the ground of national comity. The state, therefore, has not merely acquiesced by silence, but her judicial tribunals have declared the adoption of the law of international comity, in the case of a suit. We have already shown that the comity of suit brings with it the comity of contract; and where the one is expressly adopted by its courts, the other must also be presumed, according to the usages of nations, unless the contrary can be shown. \* \* \*

*Reversed.*

*Note.* Compare: 1884, Gloucester Ferry Co. v. Penn., 114 U. S. 205; 1887, Steamship Co. v. Penn., 122 U. S. 326; 1887, Stockton v. B. & N. Y. R. Co., 32 Fed. Rep. 9; 1890, Crutcher v. Kentucky, 141 U. S. 47.

In the case of Crutcher v. Kentucky, 141 U. S. 47, on p. 57, Mr. Justice Brandeis stated the right of foreign corporations to do business within any state in language that seems to imply a much broader right than has generally been supposed to exist under the rule in Bank of Augusta v. Earle, *supra*; the following is the statement: "If a partnership firm of individuals should undertake to carry on the business of interstate commerce between Kentucky and other states, it would not be within the province of the state legislature to exact conditions on which they should carry on their business, nor to require them to take out a license therefor. To carry on interstate commerce is not a franchise or a privilege granted by the state; it is a right which every citizen of the United States is entitled to exercise under the constitution and laws of the United States; and the accession of mere corporate facilities, as a matter of convenience in carrying on their business, can not have the effect of depriving them of such right, unless congress should see fit to interpose some contrary regulation on the subject."

## Sec. 478. Same.

DEMAREST V. FLACK ET AL.<sup>1</sup>

1891. IN THE COURT OF APPEALS OF NEW YORK. 128 N. Y. 205,  
28 N. E. Rep. 645.

[Appeal from common pleas of New-York city and county, general term.]

Action by Frances E. Demarest, an infant, by her guardian, etc., against Hugh J. Grant, James A. Flack, Alfred de Cordova, Frank Hardy, and Gabriel Case, composing the America's Winter Carnival Company, for damages alleged to be due to negligence in the operation of a toboggan slide. At the trial the complaint was dismissed, and plaintiff's exceptions were ordered to be heard in the first instance at the general term, which overruled the exceptions, and ordered judgment for defendants. From the judgment plaintiff appealed. Code W. Va., ch. 54, section 10, provides that, "when a certificate of incorporation shall be issued by the secretary of state pursuant to this chapter, the corporators named in the agreement recited therein, and who have signed the same, and their successors and assigns, shall, from the date of the said certificate until the time designated in the said agreement for the expiration thereof, unless sooner dissolved according to the law, be a corporation by the name and for the purposes therein specified."

The plaintiff alleged in her complaint that the defendants were a joint stock company doing business in New York city under the name and style of "America's Winter Carnival Company." The defendants, by answer, denied that they were a joint stock company, and also all allegations of negligence, either on their own part or on that of any of their employes. The evidence tending to show even a *prima facie* liability on the part of the defendants is of the most meager character. We will assume, however, that the plaintiff proved enough to call upon the defendants for an answer to her cause of action. This answer was, in brief, that the defendants were nothing but individual members of and stockholders in an incorporated company which had hired the grounds, owned the toboggans, and operated the slides; and that whatever liability there was, if any, in favor of the plaintiff, was borne by the incorporated company, and not by the individual stockholders therein. To prove this defense the counsel for defendants offered in evidence a certificate of incorporation of the company, under the laws of West Virginia, and at the same time the code of West Virginia. The certificate and the code were objected to by the plaintiff's counsel; the ground of objection to the certificate being that it was incompetent, immaterial, and illegal, and raised the question of the validity of the incorporation itself, and of its sufficiency as a defense.

PECKHAM, J. \* \* \* [After giving the details of the West

<sup>1</sup> Statement abridged; part of opinion omitted.



Virginia law, and holding it was not a question for the jury to pass upon, proceeds:]

The agreement which was signed by the incorporators in this case, and duly acknowledged and presented to the secretary of state of West Virginia, showed that the incorporators were residents of New York, and that the principal office of the corporation was to be in New York; and the inference was a fair one that the principal business of the corporation was also to be conducted in New York. The secretary of state, to whom the papers for the organization of the corporation were presented, was compelled to pass upon and decide the question whether they conformed to the laws of West Virginia, before he received or filed them, or gave the certificate of incorporation. He did pass upon the question and did thereupon issue the certificate of incorporation under the great seal of the state, and attested by his official signature. So far as the laws of West Virginia are concerned, it is plain that the incorporators thereupon became a corporation, and in that state the certificate was, by the laws thereof, evidence of the existence of such corporation. There was no fraud or evasion of the law of West Virginia in thus becoming incorporated. The references to her laws above made show conclusively that the formation of corporations thus composed, and for the purpose of doing their principal business outside the limits of that state, was contemplated in those laws. This corporation was beyond all question legally incorporated, and entitled to recognition, in the state of West Virginia. Unless, therefore, it can be said that the acts of our citizens in procuring an incorporation under the laws of West Virginia for the purpose of doing business here were, as matter of law, a fraud and an evasion of our own laws, and hence in conflict or inconsistent with our domestic policy, such foreign corporation is entitled to recognition and protection in our own tribunals. *Merrick v. Van Santvoord*, 34 N. Y. 208. It is urged that such acts are thus inconsistent and in conflict with our policy, because citizens of our own state are in that way enabled to evade our own laws relative to home corporations, and to avoid personal liability by incorporating under the laws of foreign states, which may be more favorable to members than are our own laws. I think, when this claim is examined in the light of our own legislation, it will be seen that there is no substantial basis for it to rest upon. An examination of our laws shows that it is, and for many years has been, the policy of this state to enlarge the facilities for the formation of corporations. General laws are on our statute-book for the formation of corporations of almost every conceivable kind, and under some one of them a corporation of the kind mentioned in this case could readily be formed. The freedom from personal liability would be as great, and could be as easily attained, under our own as under the laws of West Virginia. The security of the creditor would not be substantially greater in the case of the domestic than in that of the foreign corporation. In the latter the creditor has the remedy by attachment, and he can obtain about as easy access to its property as if it were domestic instead of for-



eign. There is really nothing to evade by incorporating under a foreign law. No harmful results flow to a creditor or to the community here by such incorporation. Where the corporation formed under another jurisdiction comes here to do business of a kind which we permit to be done by corporations, and where our laws provide for incorporating individuals for the purpose of doing that business, it is difficult to see how the terms "evasion" and "fraud" can be properly applied to acts of our citizens whereby they obtain incorporation in another state. When they come to our state to do business, they must conform to our laws relating to foreign corporations, and comply with the terms laid down by us as conditions of allowing them to transact business here. In the case of many kinds of corporations such conditions have already been imposed by our laws; and, if there be any kind where none is imposed, it is conclusive evidence that up to this time the legislature has not thought it conducive to the true interests of the state and its citizens to impose them. I do not intimate that it is necessary for a state to expressly, by statute, exclude foreign corporations from acting within its jurisdiction. The policy of the state may exclude them, and that policy may be clearly established by a reference to the general legislation of a state. I find none such in the laws of this state. \* \* \*

[Citing and commenting on *Montgomery v. Forbes*, 148 Mass. 249, 19 N. E. Rep. 342, and *Hill v. Beach*, 12 N. J. Eq. 31.]

We recognize corporations formed by the citizens of a foreign state under its laws for the purpose of doing business, among other places, in our own state. Where is the essential difference between such a corporation and one legally incorporated under such foreign state for the same purpose, but the members of which are citizens of our own state? Whose rights are jeopardized more in the case where the members of the corporation are our own citizens than where they are citizens of a foreign state? What enlightened policy is violated by the recognition of the foreign corporation composed of residents of this state which would not also and equally suffer by the recognition thereof when composed of non-residents? And yet, beyond all cavil, our policy is to recognize the latter. The truth is, foreign corporations are not properly to be regarded with suspicion, nor should unnecessary restraints be imposed upon their doing business in our midst. They carry no black flag, and the policy of all civilized nations is to grant them recognition in their courts. It seems to me that every reason which urges upon us the recognition of foreign corporations organized with power to do business in our state, and composed of citizens of the foreign state, is equally potent when the foreign corporation is composed of our own citizens. It has always been supposed that a state should at least deal as liberally with its own citizens as with those of foreign states. If, therefore, we permit foreign citizens to come within our limits in the form of a foreign corporation organized with power to do business here, and recognized by us, why should we not permit our own citizens to avail themselves of the like privilege? If we impose terms and conditions upon foreign corporations,

as such, doing business here, those same terms and conditions still and equally apply to a foreign corporation when composed of our own citizens. Why should they not be placed at least upon an equality with the foreign citizen? \* \* \* [Distinguishing Railway, etc., Co. v. Board, 6 Kan. 245, and Empire Mills v. Alston Grocery Co., 15 S. W. Rep. 200, 505.] The result is that the complaint was properly dismissed, and the judgment to that effect should be affirmed, with costs. All concur.

*Note.* In the last few years it has become usual for the great "incorporated trusts," organized under the New Jersey, Delaware, or West Virginia laws, to state their capacity to do corporate business away from the state of their incorporation in language broad enough to enable them to do business anywhere "in heaven above, or in the earth beneath, or in the waters under the earth," although they are duly warned by a higher law not to make unto themselves any graven image or likeness of anything that is found therein.

*Accord:* 1853, Trowbridge v. Scudder, 11 Cush. (Mass.) 83; 1866, Merrick v. Van Santvoord, 34 N. Y. 208; 1878, National Bank v. Hall, 35 O. St. 158; 1879, Central R. Co. v. Penn. R. Co., 31 N. J. Eq. 475, 485 (citizens of other states can incorporate in New Jersey to build a railroad in New Jersey); 1880, Humphreys v. Mooney, 5 Colo. 282, on 292; 1892, Wright v. Lee, 2 So. Dak. 595, 604; 1893, Missouri, etc., Co. v. Reinhard, 114 Mo. 218, *supra*, p. 844; 1894, Lancaster v. Amsterdam Imp. Co., 140 N. Y. 576, 24 L. R. A. 322, note; 1894, Oakdale, etc., Co. v. Garst, 18 R. I. 484, 49 Am. St. Rep. 784; 1900, State v. Topeka Water Co., 61 Kan. 547, 60 Pac. Rep. 337. *Contra:* 1858, Hill v. Beach, 12 N. J. Eq. 31; 1870, Land Grant, etc., R. Co. v. Coffey Co., 6 Kan. 245; 1873, Booth v. Wonderly, 36 N. J. L. 250; 1889, Montgomery v. Forbes, 148 Mass. 249, *supra*, p. 594; 1891, Empire Mills v. Alston Grocery, 4 Will. (Tex. App. Civ. Cas.) 346, 12 L. R. A. 366; 1895, Taylor v. Branham, 35 Fla. 297, 48 Am. St. Rep. 249, note 254; 1901, Pinney v. Nelson, 182 U. S. 144.

## Sec. 479. (3) To sue in State Courts.

### (a) Generally.

See: The Silver Lake Bank v. North, 4 Johns. Ch. 370, *supra*, p. 1092; Garratt Ford Co. v. Vermont M'f'g Co., 20 R. I. 187, *supra*, p. 1093; Taber v. Interstate Building & L. Assn., 91 Tex. 92, *supra*, p. 1095.

*Note.* Foreign corporations can not be excluded from suing in the state courts upon transactions of interstate commerce: 1893, Cone Export and Com. Co. v. Poole, 41 S. C. 70, 24 L. R. A. 289, note; 1897, Miller v. Goodman, 91 Tex. 41; 1899, Pasteur Vaccine Co. v. Burkey, 22 Tex. Civ. App. 232, 54 S. W. Rep. 804; 1899, Gale Manufacturing Co. v. Finkelstein, 22 Tex. Civ. App. 241, 54 S. W. Rep. 619; 1900, Waters-Pierce Oil Co. v. Texas, 177 U. S. 28.

Power to acquire property by eminent domain: 1894, New York & N. H. R. R. Co. v. Welsh, 143 N. Y. 411, 42 Am. St. Rep. 734; 1894, Myers v. McGavrock, 39 Neb. 843, 42 Am. St. Rep. 627; 1900, San Antonio & Ark., etc., Ry. Co. v. Southwestern Tel., etc., Co., 93 Tex. 313, 77 Am. St. Rep. 884.

**Sec. 480. Same. (b)** To sue non-residents.

**NATIONAL TELEPHONE MANUFACTURING COMPANY v. DU BOIS.**<sup>1</sup>

1896. IN THE SUPREME JUDICIAL COURT OF MASSACHUSETTS. 165  
Mass. Rep. 117-119, 52 Am. St. Rep. 503.

MORTON, J. The plaintiff in this case is a New Hampshire corporation with a place of business in Boston, whose claim had not been reduced to judgment, and does not relate to a contract made in this state. The claim is for labor, materials, and disbursements performed, furnished, and made in the state of Pennsylvania. The principal defendant is a resident of Pennsylvania, with no property here except his interest as partner in a firm whose property, assets, books, vouchers, papers, and accounts are all, with some few exceptions, in Du Bois, in the state of Pennsylvania, where its business chiefly is carried on, and where one of the other two partners lives with the principal defendant. The service is by publication.

The courts of equity in this state are not opened to the plaintiff as matter of strict right, but as matter of comity. *Smith v. Mutual Life Ins. Co.*, 14 Allen 336, 339. And if it appears that complete justice can not be done here, or that the amount involved is small and the defendant will be subjected to great and unnecessary expense and inconvenience, and that the investigation required will be surrounded, if conducted here, with many and great if not insuperable difficulties, which will all be avoided without especial hardships to the plaintiff if suit is brought against the defendant in the state where he lives and where the alleged debt was contracted, and where personal service can be made on him, we think that our courts should decline to take jurisdiction. *Post and Co. v. Toledo, Cincinnati and St Louis Railroad*, 144 Mass. 341; *Pierce v. Equitable Assurance Society*, 145 Mass. 56; *Bank of North America v. Rindge*, 154 Mass. 203.

All of these circumstances are found in this case. The amount of the claim is \$72.75. \* \* \*

There has been no personal service in this proceeding. According to the agreed facts, it is manifest that the principal defendant will be subjected to great and unnecessary expense if compelled to come here, and that the investigation required to ascertain his interest will be surrounded with difficulties, which will all be avoided without any apparent hardship to the plaintiff if it brings its suit in Pennsylvania.

\* \* \* *Bill dismissed.*

See, notes, 52 Am. St. Rep. 505; 95 Am. Dec. 537.

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**Sec. 481. Same. (c)** In the United States Courts.

See *Insurance Co. v. Morse*, 20 Wall. 445, *supra*, p. 1097.

<sup>1</sup> Small part of opinion omitted.

## ARTICLE II. RIGHTS OF THE STATE AS TO FOREIGN CORPORATION.

Sec. 482. (1) To exclude, general rule.

DOYLE v. CONTINENTAL INSURANCE COMPANY.<sup>1</sup>

1876. IN THE SUPREME COURT OF THE UNITED STATES. 94 U. S.  
Rep. 535-544.

[Appeal from decree of circuit court, perpetually enjoining the secretary of state, Doyle, from revoking a license issued in Wisconsin. The company was organized in Connecticut, and, prior to the Wisconsin act of 1870, had established agencies and done business in Wisconsin. After the passage of the act of 1870, the company complied with the provisions of that act, which required it to appoint an attorney on whom process could be served in Wisconsin, and agreed that it would not remove a suit arising in that state to the federal courts, whereupon the secretary of state issued a license to do business in the state. After the decision of *Insurance Co. v. Morse*, the company removed a suit to the federal courts, whereupon the secretary of state, under authority of an act of the legislature, threatened and was about to revoke the license to do business within the state, to the irreparable damage of the company. Upon demurrer, decree as above, from which Doyle appealed.]

MR. JUSTICE HUNT: The case of *Insurance Company v. Morse*, 20 Wall. 445, is the basis of the bill of complaint in the present suit. We have carefully reviewed our decision in that case, and are satisfied with it. In that case an agreement not to remove any suit brought against it in the state courts of Wisconsin into the federal courts had been made by the company, in compliance with the Wisconsin statute of 1870. The company, nevertheless, did take all the steps required by the United States statute of 1789 to remove its suit with *Morse* from the state court into the federal courts. Disregarding that action the supreme court of Wisconsin allowed the action in the state court to proceed to judgment against the company, as if no transfer had been made. When the judgment thus obtained was brought into this court, we held it to be illegally obtained, and reversed it. It was held, first, upon the general principles of law, that although an individual may lawfully omit to exercise his right to transfer a particular case from the state courts to the federal courts, and may do this as often as he thinks fit in each recurring case, he can not bind himself in advance by an agreement which may be specifically enforced thus to forfeit his rights. This was upon the principle that every man is entitled to resort to all the courts of the country to invoke the protection which all the laws and all the courts may afford him, and that he can not barter away his life, his freedom, or his constitutional rights.

<sup>1</sup> Statement abridged. Arguments and part of opinion omitted; also, dissenting opinion of Bradley, J. (Swayne and Miller, JJ., concurring), omitted.

As to the effect of the statutory requirement of the agreement, the opinion at page 458 of the case as reported, is in these words:

“ On this branch of the case the conclusion is this:

“ 1st. The constitution of the United States secures to citizens of another state than that in which suit is brought an absolute right to remove their cases into the federal court, upon compliance with the terms of the act of 1789.

“ 2d. The statute of Wisconsin is an obstruction to this right, is repugnant to the constitution of the United States and the laws in pursuance thereof, and is illegal and void.

“ 3d. The agreement of the insurance company derives no support from an unconstitutional statute, and is void, as it would be had no such statute been passed.”

The opinion of a court must always be read in connection with the facts upon which it is based. Thus, the second conclusion above recited, that the statute of Wisconsin is repugnant to the constitution of the United States and is illegal and void, must be understood as spoken of the provision of the statute under review; to wit, that portion thereof requiring a stipulation not to transfer causes to the courts of the United States. The decision was upon that portion of the statute only, and other portions thereof, when they are presented, must be judged of upon their merits.

We have not decided that the state of Wisconsin had not the power to impose terms and conditions as preliminary to the right of an insurance company to appoint agents, keep offices, and issue policies in that state. On the contrary, the case of *Paul v. Virginia*, 8 Wall. 168, where it is held that such conditions may be imposed, was cited with approval in *Insurance Co. v. Morse*. \* \* \*

Neither did *Insurance Co. v. Morse*, *supra*, undertake to decide what are the powers of the state of Wisconsin, in revoking a license previously granted to an insurance company, for what causes or upon what grounds its action in that respect may be based. No such question arose upon the facts, or was argued by counsel, or referred to in the opinion of the court.

The case now before us does present that point, and with distinctness.

The complainant alleges that a license had been granted to the Continental Insurance Company, upon its executing an agreement that it would not remove any suit against it from the tribunal of the state to the federal courts; that in the case of *Drake* it did, on the tenth day of March, 1875, transfer his suit from the Winnebago circuit of the state to the circuit court of the United States; that *Drake* thereupon demanded that the defendant, who is secretary of state of Wisconsin, should revoke and annul its license, in accordance with the provisions of the act of 1872; that it is insisted that he has power to do so summarily, without notice or trial; that the complainant is fearful that he will do so, and that it will be done simply and only for the reason that the complainant transferred to the federal court the case of *Drake*, as above set forth.

The cases of *Bank of Augusta v. Earle*, *Ducat v. Chicago*, *Paul v. Virginia*, and *Lafayette Insurance Co. v. French*, establish the principle that a state may impose upon a foreign corporation, as a condition of coming into or doing business within its territory, any terms, conditions and restrictions it may think proper, that are not repugnant to the constitution or laws of the United States. The point is elaborated at great length by Chief Justice Taney in the case first named, and by Mr. Justice Field in the case last named.

The correlative power to revoke or recall a permission is a necessary consequence of the main power. A mere license by a state is always revocable. *Rector v. Philadelphia*, 24 How. 300; *People v. Roper*, 35 N. Y. 629; *People v. Commissioners*, 47 N. Y. 501. The power to revoke can only be restrained, if at all, by an explicit contract upon good consideration to that effect. *Humphrey v. Pegues*, 16 Wall. 244; *Tomlinson v. Jessup*, 15 Wall. 454.

A license to a foreign corporation to enter a state does not involve a permanent right to remain. Subject to the laws and constitution of the United States, full power and control over its territories, its citizens, and its business, belong to the state.

If the state has the power to do an act, its intention or the reason by which it is influenced in doing it can not be inquired into. Thus, the pleading before us alleges that the permission of the Continental Insurance Company, to transact its business in Wisconsin, is about to be revoked, for the reason that it removed the case of Drake from the state to the federal courts.

If the act of an individual is within the terms of the law, whatever may be the reason which governs him, or whatever may be the result, it can not be impeached. The acts of a state are subject to still less inquiry, either as to the act itself or as to the reason for it. The state of Wisconsin, except so far as its connection with the constitution and laws of the United States alters its position, is a sovereign state, possessing all the powers of the most absolute government in the world.

The argument that the revocation in question is made for an unconstitutional reason can not be sustained. The suggestion confounds an act with an emotion or a mental proceeding, which is not the subject of inquiry in determining the validity of a statute. An unconstitutional reason or intention is an impracticable suggestion, which can not be applied to the affairs of life. If the act done by the state is legal, is not in violation of the constitution or laws of the United States, it is quite out of the power of any court to inquire what was the intention of those who enacted the law. \* \* \*

The statute of Wisconsin declares that if a foreign insurance company shall remove any case from its state court into the federal courts, contrary to the provisions of the act of 1870, it shall be the duty of the secretary of state immediately to cancel its license to do business within the state. If the state has the power to cancel the license, it has the power to judge of the cases in which the cancellation shall be made. It has the power to determine for what causes and in what manner the revocation shall be made.



It is said that we thus indirectly sanction what we condemn when presented directly; to wit, that we enable the state of Wisconsin to enforce an agreement to abstain from the federal courts. This is an "inexact statement." The effect of our decision in this respect is that the state may compel the foreign company to abstain from the federal courts, or to cease to do business in the state. It gives the company the option. This is justifiable, because the complainant has no constitutional right to do business in that state; that state has authority at any time to declare that it shall not transact business there. This is the whole point of the case, and, without reference to the injustice, the prejudice, or the wrong that is alleged to exist, must determine the question. No right of the complainant under the laws or constitution of the United States, by its exclusion from the state, is infringed, and this is what the state now accomplishes. There is nothing, therefore, that will justify the interference of this court.

*Reversed.*

*Note:* See, 1857, *Shelby v. Hoffman*, 7 Oh. St. 450; 1869, *Hobbs v. Manhattan Ins. Co.*, 56 Me. 417, 96 Am. Dec. 472; 1870, *Morton v. Mut. Life Ins. Co.*, 105 Mass. 141, 7 Am. Rep. 505; 1870, *People v. Glens Falls Ins. Co.*, 21 Mich. 577, 4 Am. Rep. 504; 1872, *W. U. Tel. Co. v. Dickinson*, 40 Ind. 444, 13 Am. Rep. 295; 1872, *N. Y. Life Ins. Co. v. Best*, 23 Oh. St. 105; 1874, *The Home Ins. Co. v. Davis*, 29 Mich. 238; 1874, *Insurance Co. v. Morse*, 20 Wall. 445; 1875, *Railway Pass. Assn. v. Pierce*, 27 Oh. St. 155; 1875, *Hartford Fire Ins. Co. v. Doyle*, 6 Biss. 461; 1876, *State v. Doyle*, 40 Wis. 175; 1886, *Goodwill v. Kriechbaum (Barron v. Burnside)*, 70 Iowa 362; 1887, *Barron v. Burnside*, 121 U. S. 186; 1889, *Rece v. N. N. & M. V. Co.*, 32 W. Va. 164; 1890, *Texas v. Worsham*, 76 Tex. 556; 1892, *Southern Pacific Co. v. Denton*, 146 U. S. 202; 1894, *Martin v. B. & O. R. Co.*, 151 U. S. 673, 684; 1895, *Commonwealth v. East Tenn. C. Co.*, 97 Ky. 238; 1898, *Louisville, N. A. & C. R. Co. v. Louisville T. Co.*, 174 U. S. 552, 563; 1900, *State v. Standard Oil Co.*, 61 Neb. 449, 87 Am. St. R. 449; 1902, *Cook v. Howland*, 74 Vt. 393, 93 Am. St. R. 912; 1903, *Cable v. U. S. Life Ins. Co.*, 191 U. S. 288.

## Sec. 483. (2) Same,—retaliatory laws.

### THE PEOPLE v. THE FIRE ASSOCIATION OF PHILADELPHIA.<sup>1</sup>

1883. IN THE COURT OF APPEALS OF NEW YORK. 92 N. Y. Rep. 1311-328, 44 Am. Rep. 380.

[Appeal from judgment of general term of the supreme court in favor of the defendant, in a suit wherein the people claimed the association should pay a tax of three per cent. of its gross premiums within the state. The question involved the constitutionality of the New York retaliatory law of 1875.]

FINCH, J. The legislation of the state relating to foreign insurance companies is challenged on this appeal as a violation of constitutional right. The act of 1875 (chapter 60) in substance provides that an insurance corporation of another state, seeking to do business

<sup>1</sup> Statement abridged; arguments and part of opinion omitted. This decision was affirmed by the supreme court of the U. S. *Phil. Fire Assn. v. New York*, 119 U. S. 110.

here, shall pay to the superintendent of the insurance department for taxes, fines, penalties, certificates of authority, license fees and otherwise, an amount equal to that imposed by the state of its origin upon companies of this state seeking to do business there, when such amount charged is greater than our own. The evident purpose of the act is to treat the corporations of another state seeking to transact business here precisely as such other state should treat our own corporations seeking to do business there. It rests upon the idea that the comity due from one state to another is not required to be more than equal and reciprocal, and what is wholly a matter of privilege may be granted or withheld upon conditions.

This legislation is assailed, first, upon the ground that it is an unlawful delegation of the legislative power, and the general term have so held upon the authority of *Barto v. Himrod* (8 N. Y. 483). We do not think that case at all decisive of this. What was there denominated the school law came from the hands of the legislature, not as a law, but as a proposition. Whether it should be a law or not was precisely the question submitted to the popular vote. The legislature proposed the law, but left it to the people to enact. \* \* \*

This court held that the legislature, under the constitution, could not so delegate its power, but was bound to determine for itself the expediency of the measure, and either enact or reject it. But nothing in that decision denied to the legislature the right to pass a law whose operation might depend upon, or be affected by, a future contingency. The opinions expressly conceded the existence of such power. It was not denied that a valid statute may be passed to take effect upon the happening of some future event, certain or uncertain. And this was said as to the character of such event, viz.: "The event or change of circumstances on which a law may be made to take effect must be such as, in the judgment of the legislature, affects the expediency of the law; an event on which the expediency of the law in the judgment of the law-makers depends. On this question of expediency the legislature must exercise its own judgment definitively and finally." The statute before us fully answers this description. It came from the hands of the legislature a complete and perfect law, having at once a binding force of its own, and dependent upon no additional consent or action for its vitality and existence. The question of expediency involved in it was not delegated to any other tribunal, but settled definitively and finally by the legislature itself. It determined, as a conclusion proper and expedient, that foreign insurance companies, as the price of admission to our territory, should pay in taxes, license fees and the like precisely what the states which created them should impose upon our companies in excess of our usual rates as the price of admission to the foreign territory. That was the whole question involved. Nothing else in the proposed law remained to be settled as expedient or otherwise, and that question the legislature determined for itself, upon its own reasons and its sole responsibility. Neither the law nor its expediency depended upon the legislation of another state. It remained the law and its expediency was the same, whether other states legis-

lated or not. If they did, the contingency arose which the law stood ready to meet; if they did not, it remained none the less the law, although no fact occurred to set it in operation. This court has steadily declined to push the doctrine of *Barto v. Himrod* beyond the point which it decided. \* \* \*

(After holding that the tax or fine was not left to the legislative discretion of another state,—and if it was, it would not be invalid.)

A second objection to the constitutionality of the act is founded upon article 14 of the federal constitution, and especially upon its final clause, which commands that no state shall “deny to any person within its jurisdiction the equal protection of the laws.” The argument here takes a wide range and touches upon questions of supreme and vital importance as to the relations of the states to each other, and of each to the United States. Corporations are claimed to be “persons” within the meaning and protection of the clause referred to; its force and operation is carried beyond the limit indicated by the emergency from which it sprang; and it is asserted to forbid unequal taxation and condemn such legislation as that under consideration. But we think these grave questions are not before us, and the clause relied upon has no application to the rights of the defendant. It is a corporation, organized and existing under the laws of Pennsylvania; a creature of those laws, and beyond their jurisdiction, carrying its corporate life and existence only by sufferance and upon an express or implied consent. It could not come within our jurisdiction, or transact business within our territory, except by our permission, either express or implied. The right of a state to exclude foreign corporations is perfectly settled and not open to debate. (*Paul v. Virginia*, 8 Wall. 168; *Bank of Augusta v. Earle*, 13 Pet. 586; *Liverpool Ins. Co. v. Massachusetts*, 10 Wall. 566; *Co. of San Mateo v. S. P. R. Co.*, 13 Fed. Rep. 722, Field, J.) Out of comity between the states has grown a right founded upon implied consent. Where a state does not forbid, or its public policy, as evidenced by its statutes, is not infringed, a foreign corporation may transact business within its boundaries and be entitled to the protection of its laws. But this right is still founded upon consent which is implied from comity and the absence of prohibition. But a state may prohibit. \* \* \*

The situation, then, is this: The state, having the power to exclude foreign corporations, determines to do so unless they will submit to certain conditions. It meets the applicant on the border, forbidding admission, as it has a right to do, except on condition that it will fulfill all of the requirements of our statutes relating to foreign corporations, one of which is the very law here assailed. When the corporation comes in it agrees to the conditions. They become binding by its assent. The tax or license fee charged by the act of 1865 is one of these conditions. It is imposed as the price of permission to come within the jurisdiction, and not as a tax upon one already within the jurisdiction. The fourteenth amendment, therefore, has no application. It can apply to foreign insurance companies only after they have performed the conditions upon which they are entitled to admis-

sion. Any other view of the case involves this absurdity: that the foreign company may agree to pay the tax charged by the act of 1865 so as to get within our jurisdiction, and then refuse to pay it while insisting upon the right to remain. It can not agree to conditions as the price of admission, and after having been admitted turn around and dispute them. Even if the conditions were unconstitutional, which can not be said of the terms of the act of 1865, considered as conditions, the foreign company could waive the objection (*Embury v. Conner*, 3 N. Y. 511; *Sherman v. McKeon*, 38 N. Y. 266; *Phyfe v. Eimer*, 45 N. Y. 102); and does do so when it accepts the conditions by coming in under them, and is estopped from raising the question. (*Vose v. Cockcroft*, 44 N. Y. 415.) Even where the condition was a violation of the federal constitution and the supreme court of the United States so declared, they refused to prevent the state from excluding the offending company and revoking its license. (*Doyle v. Continental Ins. Co.*, 94 U. S. 535.)

The constitutional difference between the rights of non-resident individuals and foreign corporations is fundamental and apparent. The citizen of another state has a constitutional right to come within our jurisdiction. The charter of the nation has secured him that right, and we can not exclude him nor clog his rights with conditions, unless in exceptional cases under the police power. But foreign corporations, artificial beings, the product of a law not our own, have no constitutional right to pass their own borders and come into ours. The federal constitution has neither granted nor secured any such right. We may exclude absolutely, and in that power is involved the right to admit upon such conditions as we please. Until they are within our jurisdiction, the final clause of article 14, by its own terms, does not apply. While they stand at the door bargaining for the right to come within, they may decline to come, but can not question our conditions if they do. How, then, is the legislation vicious which proposes to treat them precisely as their own state treats our corporations similarly situated? Is exact equality unfair? Must comity become magnanimity or injustice? If we owe courtesy to sister states, do we not also owe protection to our own corporations, formed and fostered under our law? Is it vicious to insist for them upon precise equality of treatment? These questions our legislature answered. The inquiry was within the just range of their discretion. This court, at least, is bound to assume, and finds no difficulty in assuming, that they answered it wisely and justly.

*Reversed.*

*Note. Retaliatory laws:* 1879, *Goldsmith v. Home Ins. Co.*, 62 Ga. 379; 1880, *Clark & Murrell v. Port of Mobile*, 67 Ala. 217; 1883, *The Phoenix Ins. Co. v. Welch*, 29 Kan. 672; 1883, *Ohio v. Moore*, 39 Ohio St. 486; 1886, *Philadelphia Fire Assn. v. New York*, 119 U. S. 110; 1887, *State, ex rel. N. E. M. L. Ins. Co., v. Reinmund*, 45 Ohio St. 214; 1888, *State of Minnesota v. Fidelity & Cas. Ins. Co.*, 39 Minn. 538; 1888, *State v. Insurance Co. of North America*, 115 Ind. 257; 1889, *State v. The Fidelity & Casualty Co.*, 77 Iowa 648; 1889, *Germania Ins. Co. v. Swigert*, 128 Ill. 237, 4 L. R. A. 473; 1890, *State of Ohio v. West. U. M. Life, etc., Soc.*, 47 Ohio St. 167, 8 L. R. A. 129; 1891, *Tal-*

bott v. Fidelity & Casualty Co., 74 Md. 536, 13 L. R. A. 584; 1892, State of Ohio v. Fidelity & Casualty Co., 49 Ohio St. 440, 34 Am. St. Rep. 573, 16 L. R. A. 611, *supra*, p. 406; 1894, People v. Fidelity & Casualty Co., 153 Ill. 25, 26 L. R. A. 295; 1894, State v. Ackerman, 51 Ohio St. 163, 24 L. R. A. 298, note; 1899, Cravens v. N. Y. Life Ins. Co., 148 Mo. 583, 71 Am. St. Rep. 628.

**Sec. 484. (3) Same,—discrimination.**

**MANCHESTER FIRE INSURANCE COMPANY v. HERRIOTT.<sup>1</sup>**

1899. IN THE UNITED STATES CIRCUIT COURT, SOUTHERN DISTRICT OF IOWA. 91 Fed. Rep. 711-720.

SHIRAS, District Judge. The bill in this case is filed on behalf of some thirty-two fire insurance companies doing business in the state of Iowa, but incorporated under the laws of Great Britain and other states foreign to the United States, the ultimate purpose of the bill being to test the constitutionality of section 1333 of the code of Iowa, which, in substance, provides that all insurance companies incorporated under the laws of a state or nation other than the United States shall, at the time of making the annual statements as required by law, pay into the state treasury  $3\frac{1}{2}$  per cent. of the gross amount of premiums received for business done in the state of Iowa during the preceding year; that all insurance companies incorporated under the laws of a sister state of the Union shall pay into the treasury  $2\frac{1}{2}$  per cent. of the gross amount of premiums received during the preceding year; and that all insurance companies incorporated under the laws of the state of Iowa, not including county, mutual, and fraternal beneficiary associations, shall pay into the treasury one per cent. of the gross amount received from premiums and assessments after deducting amounts paid for losses and premiums returned; it being further provided that upon payment of the proper sums duplicate receipts therefor should be issued, one of which must be filed with the auditor of state, who is then authorized to issue the annual certificate requisite to enable the company to continue in business during the coming year.

In the bill filed it is averred that the complainant companies, more than fifteen years ago, were admitted into the state of Iowa for the purpose of transacting the business of insurance, and that they then fully complied with all the provisions and requirements of the laws of Iowa necessary to secure their lawful admission into and recognition by the state, and that they have since complied each year with the requirement of the state laws, and have each year had issued to them the certificate showing their authorization to continue in business in Iowa. It is further averred that in reliance upon this action on part of the state the complainants have expended large sums of money in establishing agencies, in securing offices, in advertising, and in providing the ma-

<sup>1</sup> Statement abridged, and part of opinion omitted.



terials necessary to conduct their business in Iowa, and that they have entered into many contracts of insurance with the citizens of Iowa, which are now in force, and have expended large amounts in meeting the obligations arising in Iowa in connection with the business which they were authorized by the state to undertake in Iowa. It is further charged in the bill that up to the year 1897 no discrimination in the burden of taxation had been made between foreign and domestic corporations engaged in the business of insurance in the state of Iowa, but that in that year the legislature enacted the existing code of Iowa, which contains the section already cited, imposing upon foreign companies a heavier and unequal burden of taxation as compared with corporations created under the laws of Iowa, and as compared with companies created under the laws of the states of the Union other than Iowa; and it is averred in the bill that the provisions of this section are in violation of the fourteenth amendment to the constitution of the United States, of the provisions of the civil rights act, and of article 8, section 2, of the constitution of the state of Iowa, which provides that "the property of all corporations for pecuniary profit shall be subject to taxation the same as that of individuals." \* \* \*

(The defendants demurred, that the suit was in effect one against the state, and also that there was no cause of complaint, but that the state legislation was constitutional. After disposing of the first point, the court proceeds:)

On behalf of complainants it is admitted that a state has the right to wholly exclude foreign corporations other than those engaged in interstate commerce or in carrying on the business of the United States from admission into the state, and it may prescribe the condition upon which such companies may enter the state; but it is claimed that if foreign companies are admitted into the state, and permitted to engage in business therein, the state is then debarred from imposing further conditions on the right to continue in business, and in the exercise of the right of taxation it can not impose any burden upon the corporation other or more onerous than is imposed on domestic corporations engaged in the like business; that when a foreign corporation is admitted within a state, and engages in business therein, having fully complied with the requirements and conditions then imposed by the law of the state, it comes within the protection of the fourteenth amendment to the federal constitution, and of the provisions of the civil rights act; and, having thus become entitled to the equal protection of the laws of the state and of the United States, it can not rightfully be subjected to a burden of taxation greater than that imposed upon like domestic corporations, and that, therefore, the provisions of section 1333 are invalid and void, because thereby corporations created under the laws of foreign countries are discriminated against as compared with corporations created under the laws of states other than Iowa, as well as when compared with corporations created under the laws of Iowa. In support of the contention of complainants, counsel have submitted a very full and elaborate brief, citing at length from numerous decisions, and have supported



the same by an able oral argument, which, if space and time permitted, ought, perhaps, to receive a more extended discussion than can now be accorded; but, as I understand the decisions of the supreme court of the United States, the pivotal questions involved in the case have been settled by that court. There can be no doubt upon the proposition that if a foreign corporation is admitted into a state, and lawfully engages in business therein, its property and rights within such state are entitled to the equal protection of the law, the same as those of a like domestic corporation; but that is not the point at issue in this case.

The provisions of section 1333 of the code do not affect the property of the companies, nor impose any lien or burden thereon. They impose a burden upon the right of the companies to continue in the business within the state after the 1st of March next. This burden is in form and in substance a tax, but it is not a tax imposed upon the tangible property of the companies. It is a burden in the form of a tax, imposed as a condition upon the right of the companies to continue in business in Iowa. It can not be denied that the state has the right to prescribe the terms, conditions, and burdens subject to which a foreign corporation can obtain the right of admission into the state, and it is beyond question that, so long as the provisions of section 1333 remain in force, no foreign corporation can secure the privilege of admission into the state, except upon a compliance with its requirements. But it is said that, after a foreign corporation has once rightfully entered the state, and engaged in business therein, no additional burden or restrictions can be imposed as a condition to the exercise of the right to continue in business. The power and right of the state to exclude foreign corporations, not engaged in interstate commerce, or in the furtherance of the business of the United States, from entering the state, includes the right to preclude such foreign corporations from continuing in business, and also includes the right to impose conditions upon such continuances. When a foreign corporation has been admitted into a state, and has, in connection with the business it was authorized to carry on, accumulated property, or entered into contracts, such property and contract rights are under the protection of the law, but the right to invoke protection for such acquired property does not confer upon the corporation the right to insist that it shall be permitted to enter into further contracts, or acquire other property, contrary to the expressed will of the state embodied in an act of the legislature.

The privilege of continuing in the business of insurance within the state, in the case of the complainant companies, is derived from the legislation of the state, and it is for the legislature to determine, from time to time, upon what terms, and subject to what conditions, such privilege will be continued to the companies. \* \* \*

(Citing *Paul v. Virginia*, 8 Wall. 168; *Ducat v. Chicago*, 10 Wall. 410, and quoting from syllabus to *Pembina Silver Min. Co. v. Pennsylvania*, 125 U. S. 181, to the effect that:)

“The only limitation upon this power of the state to exclude a for-

foreign corporation from doing business within its limits, or hiring offices for that purpose, or to exact conditions for allowing the corporation to do business or hire offices there, arises where the corporation is in the employ of the federal government, or where its business is strictly commerce, interstate or foreign." \* \* \*

(Quoting from *Doyle v. Ins. Co.*, 94 U. S. 535, to the effect that:)

"A license to a foreign corporation to enter a state does not involve a permanent right to remain."

An examination of the statutes of the state of Iowa shows that for years it has been incumbent upon all foreign insurance companies to obtain a renewal in each year of their license to continue in business in the state, and, unless such license in the form of a certificate was issued, the company had no right to continue the transaction of insurance within the state. The ground of complaint in the present instance is that the state has imposed certain conditions as a prerequisite to the issuance of a license enabling the companies to continue in business during the coming year, and these conditions are complained of as onerous, and as making a discrimination between the license tax exacted from corporations created under the laws of other nations, as compared with domestic or sister state corporations. In *Pembina Con. Silver Mining & Milling Co. v. Pennsylvania*, 125 U. S. 181, 8 Sup. Ct. 737, it is expressly held that "the state is not prohibited from discriminating in the privileges it may grant to foreign corporations as a condition of their doing business or hiring offices within its limits"; and if it be true—as it undoubtedly is—that the state may impose such conditions as it deems best upon the privilege of obtaining a license to do business in the state during the coming year, the courts can not release the companies from the obligation to perform the conditions, if they wish to continue in business during the coming year. If the conditions imposed are onerous, discriminatory, or otherwise inexpedient, relief must come from the legislature, and not from the courts. The argument for complainants is largely based upon the thought that, when foreign corporations are once admitted within the state, they are entitled, under the provisions of the state and federal constitutions, to insist that they shall be subjected to the same burdens of taxation as may be imposed upon similar corporations engaged in the like business. If the license tax provided for in section 1333 was a tax upon property, real or personal, owned by the companies within the state, there would be much force in the argument; but that is not the fact. This license tax is the condition imposed by the state upon the privilege of engaging or continuing in business within the state. It is optional with the companies whether they will subject themselves to the burden or not, but they can not enjoy the privilege of continuing in business in the state, except upon compliance with the terms which the state has seen fit to impose as a condition to the exercise of the privilege. In the adoption of section 1333 the state was not exercising its right to subject property or persons within the state to a proper burden of taxation, in which event it would have been subject to the provisions of the state constitution re-

quiring equality in the burdens imposed; but the state was exercising its undoubted right to prescribe the terms upon which foreign corporations may be allowed to continue in the business of insurance within the state, and, as the right to impose terms is possessed by the state, it is not for the courts to question the expediency or justice of the conditions enacted by the state. \* \* \*

*Demurrer sustained.*

*Note.* Discrimination against corporations.

(a) *Domestic* corporations are *persons* in the state, within the provisions of the fourteenth amendment, forbidding the states from depriving persons of property without due process of the law, or denying any person within its jurisdiction the equal protection of the laws. See *R. Tax Cases*, 13 Fed. Rep. 722, *supra*, § 7, p. 36, and note, par. 10, *supra*, p. 56; also note, *supra*, § 448.

(b) Foreign corporations that have obtained the state's consent to do business in a state, and have thereby acquired property, or property rights, are also persons within the provisions of the fourteenth amendment. *Supra*, § 476, and note. But revocation of permission is not the infliction of a penalty, nor the deprivation of a right, but merely the cancellation of a license: 1900, *State v. Standard Oil Co.*, 61 Neb. 28, 87 Am. St. R. 449, 84 N. W. 413; 1902, *Cook v. Howard*, 74 Vt. 393, 93 Am. St. R. 912.

(c) This, however, does not prevent the state from classifying either domestic or foreign corporations, for taxation or regulation under the police powers, and applying different rules to the various classes, when the classification and rules are not merely arbitrary but have a reasonable basis. 1887, *Hayes v. Missouri*, 120 U. S. 68; 1888, *Missouri Pac. R. v. Mackey*, 127 U. S. 205; 1888, *Walston v. Nevin*, 128 U. S. 578; 1890, *Bells Gap, etc., Co. v. Pennsylvania*, 134 U. S. 232; 1892, *Pacific Express Co. v. Seibert*, 142 U. S. 339; 1893, *Giozza v. Tiernan*, 148 U. S. 657; 1894, *Columbia So. R. Co. v. Wright*, 151 U. S. 470; 1894, *Marchant v. Penn. R.*, 153 U. S. 380; 1897, *St. Louis & S. F. R. v. Matthews*, 165 U. S. 1; 1897, *Gulf Col., etc., R. v. Ellis*, 165 U. S. 150.

(d) And as to foreign corporations the state can discriminate in any way it sees fit, in regard to the privilege to enter, or continue in, the state and do business therein, that does not deprive them of their property, or interfere with interstate or foreign commerce, or commerce with the Indian tribes, or does not burden them as an agency of the United States government. 1870, *Ducat v. Chicago*, 10 Wall. 410; 1886, *Philadelphia Fire Association v. New York*, 119 U. S. 110, 120; 1888, *Pembina Consol. M. & M. Co. v. Pennsylvania*, 125 U. S. 181; 1898, *Orient Ins. Co. v. Daggs*, 172 U. S. 557; 1899, *Scottish U. & Natl. Ins. Co. v. Herriott*, 109 Iowa 606, 80 N. W. Rep. 665, 77 Am. St. Rep. 548; 1900, *Hawley v. Hurd*, 72 Vt. 122, 82 Am. St. Rep. 922, 52 L. R. A. 195, 47 Atl. 401; 1901, *Blue Jacket Consol. C. Co. v. Scherr*, — W. Va. —, 40 S. E. 514; 1901, *Floyd v. Nat'l L. & I. Co.*, 49 W. Va. 327, 87 Am. St. R. 805, 1902, *Cook v. Howard*, 74 Vt. 393, 93 Am. St. R. 912, 52 Atl. 973.

Compare, 1899, *Johnson v. Goodyear Mining Co.*, 127 Cal. 4, 47 L. R. A. 338. See notes, §§ 10, 476, *supra*, and § 733, *infra*.

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#### Sec. 485. (4) Limits on powers to exclude,—government agency.

See *Telegraph Company v. Texas*, 105 U. S. 460, *supra*, p. 1397; *Pensacola Telegraph Co. v. Western U. Tel. Co.*, 96 U. S. 1, *supra*, p. 326.

*Note.* As to railroads, see next note.

Sec. 486. (5) Limits on power to exclude,—interstate commerce.

MR. JUSTICE MATTHEWS (MR. JUSTICE BLATCHFORD CONCURRING),  
IN COOPER MANUFACTURING COMPANY v. FERGUSON.<sup>1</sup>

1885. IN THE SUPREME COURT OF THE UNITED STATES. 113 U. S.  
Rep. 727-737, on 736-7.

[Suit by the company to recover damages for breach of a contract, whereby Ferguson agreed to purchase of the company, an Ohio corporation, a steam engine. The contract was made in Colorado, whose constitution provided that no foreign corporation should "do any business in this state without having one or more known places of business and an authorized agent or agents in the same upon whom process may be served;" the statutes provided that foreign corporations before doing *any business* in the state should file with the secretary of state, and in the county recorder's office, a certificate stating the place of business and the name of an agent for service of summons. The corporation at the time of making the contract, or bringing the suit, had not complied with these provisions, and the defendant so pleaded. Upon demurrer to these pleas, the circuit court overruled the demurrer and gave judgment for defendant; this is the error claimed.]

Whatever power may be conceded to a state, to prescribe conditions on which foreign corporations may transact business within its limits, it can not be admitted to extend so far as to prohibit or regulate commerce among the states; for that would be to invade the jurisdiction which, by the terms of the constitution of the United States, is conferred exclusively upon congress.

In the present case, the construction claimed for the constitution of Colorado, and the statute of that state passed in execution of it, can not be extended to prevent the plaintiff in error, a corporation of another state, from transacting any business in Colorado, which, of itself, is commerce. The transaction in question was clearly of that character. It was the making of a contract in Colorado to manufacture certain machinery in Ohio, to be there delivered for transportation to the purchasers in Colorado. That was commerce; and to prohibit it, except upon conditions, is to regulate commerce between Colorado and Ohio, which is within the exclusive province of congress. It is quite competent, no doubt, for Colorado to prohibit a foreign corporation from acquiring a domicile in that state, and to prohibit it from carrying on within that state its business of manufacturing machinery. But it can not prohibit it from selling in Colorado, by contracts made there, its machinery manufactured elsewhere, for that would be to regulate commerce among the states.

In *Paul v. Virginia*, 8 Wall. 168, the issuing of a policy of in-

<sup>1</sup>Statement abridged; arguments and opinion of the court by Mr. Justice Woods (the result being concurred in by Matthews and Blatchford, JJ., for reasons here given) omitted.

insurance was expressly held not to be a transaction of commerce, and, therefore, not excluded from the control of state laws; and the decision in that case is predicated upon that distinction. It is, therefore, not inconsistent with these views.

*Reversed.*

*Note.* Interstate or foreign commerce.

(a) *Definitions*—Commerce in its broad sense means “interchange of goods, merchandise, or property of any kind; trade, traffic; used more especially of trade on a large scale carried on by transportation of merchandise between different countries, or between different parts of the same country.”—Century Dictionary.

“Commerce undoubtedly is traffic, but it is something more,—it is intercourse.” Marshall, C. J., in *Gibbons v. Ogden*, 9 Wheat. 1.

“Commerce is a term of the largest import. It comprehends intercourse for the purposes of trade in any and all its forms, including transportation, purchase, sale, and exchange of commodities between the citizens of one country and the citizens or subjects of other countries, and between the citizens of different states.” Field, J., in *Welton v. Missouri*, 91 U. S. 275.

“Commerce with foreign countries and among the states, strictly considered, consists in intercourse and traffic, including in these terms navigation, and the transportation and transit of persons and property, as well as the purchase, sale, and exchange of commodities.” Field, J., in *County of Mobile v. Kimball*, 102 U. S. 691; *Gloucester Ferry Co. v. Pennsylvania*, 114 U. S. 196 on 204.

Mr. Justice Lamar, in *McCall v. California*, 136 U. S. 104, quotes approvingly Pomeroy’s *Constl. Law*, p. 376, where it is said of commerce: “It includes the fact of intercourse and traffic, and the subject-matter of intercourse and traffic. The fact of intercourse and traffic, again, embraces all the means, instruments, and places by and in which intercourse and traffic are carried on, and further still, comprehends the acts of carrying them on at these places, and by and with these means. The subject-matter of intercourse or traffic may be either things, goods, chattels, merchandise or persons.”

Webster defines commerce as “the exchange of merchandise on a large scale between different places or communities;” this embraces two distinct ideas, *exchange*, either by barter or sale, and *transportation*.

(b) *Manufacturing, growing, or making things*, even though the intention is to sell them in other states, is not interstate commerce, or commerce of any kind: 1894, U. S. v. *E. C. Knight Co.*, 156 U. S. 1; 1899, *Fox v. State*, 89 Md. 381, 72 Am. St. Rep. 193.

But making things to order, upon sales previously made, and to be shipped from one state into another, is a transaction of interstate commerce: 1885, *Cooper v. Ferguson*, 113 U. S. 727; 1894, *Milan, etc., Co. v. Gorten*, 93 Tenn. 590, 26 L. R. A. 135; 1897, *State v. Scott*, 98 Tenn. 254; 1898, *Talbutt v. State*, 39 Tex. Crim. Rep. 64, 73 Am. St. Rep. 903; 1903, *Caldwell v. North Carolina*, 187 U. S. 622.

(c) The *fact of intercourse* includes purchases and sales of goods that are to be sent across state lines.

*Sales*: The negotiation of the sale of goods which are in other states, whether by solicitor or by sample, is interstate commerce. “To tax the sale of such goods, or the offer to sell them, before they are brought into the state, is \* \* \* clearly a tax on interstate commerce:” 1885, *Cooper v. Ferguson*, 113 U. S. 727, *supra*, p. 1503; 1887, *Robbins v. Shelby Taxing Dist.*, 120 U. S. 489, 59 Am. Rep. 267; 1887, *Corson v. Maryland*, 120 U. S. 502; 1889, *McCall v. California*, 136 U. S. 104; 1891, *Tredway v. Riley*, 32 Neb. 495, 29 Am. St. Rep. 447; 1891, *City of Bloomington v. Bourland*, 137 Ill. 534, 31 Am. St. Rep. 382; 1892, *Gunn v. White Sew. Mach. Co.*, 57 Ark. 24, 38 Am. St. Rep. 223; 1892, *Cook v. Rome Brick Co.*, 98 Ala. 409; 1893, *Kindel v. Beck, etc., Co.*, 19 Colo. 310, 24 L. R. A. 311, note; 1894, *Milan, etc., Co. v. Gorten*, 93 Tenn. 590, 26 L. R. A. 135; 1896, *Toledo Com. Co. v. Glen Mfg. Co.*,



55 Ohio St. 217; 1897, *State v. Scott*, 98 Tenn. 254; 1897, *Miller v. Goodman*, 15 Tex. Civ. App. 244, 7 Am. & E. C. C. (N. S.) 177; 1898, *Talbutt v. State*, 39 Tex. Cr. Rep. 64, 73 Am. St. Rep. 903; 1898, *Mearshon v. Pottsville Lumber Co.*, 187 Pa. St. 12, 67 Am. St. Rep. 560. Compare, 1886, *State v. Long*, 95 N. C. 582, 59 Am. Rep. 263; 1897, *Allen v. Jones Buggy Co.*, 91 Tex. 22, 6 Am. & E. C. C. (N. S.) 670; 1902, *Stockard v. Morgan*, 185 U. S. 27; 1908, *Norfolk & West. Ry. v. Sims*, 191 U. S. 441.

**Purchases:** Contracts for the purchase of goods between citizens of different states, made in either state, is a transaction of interstate commerce: 1890, *Colorado I. W. Co. v. Sierra Grande, etc., Co.*, 15 Colo. 499; 1890, *Ware v. Hamilton Brown, etc.*, 92 Ala. 145; 1897, *McNaughton v. McGirl*, 20 Mont. 124, 63 Am. St. Rep. 610.

(d) *The fact of intercourse* also includes communication between persons, the transmission of intelligence, the transit of persons, or the transportation of persons or property, either actual or contemplated, in completion of a commercial transaction, and when across state lines constitute interstate or foreign commerce: 1876, *Council Bluffs v. Kansas City R.*, 45 Iowa 338, 24 Am. Rep. 773; 1887, *Steamship Co. v. Pennsylvania*, 122 U. S. 326; 1893, *Kendel v. Beck & Pauli Lith. Co.*, 19 Colo. 310, 24 L. R. A. 311, note.

**Telegraph and telephone**,—transmission of intelligence by such instrumentalities, across state lines, is interstate intercourse: 1877, *Pensacola Tel. Co. v. W. U. Tel. Co.*, 96 U. S. 1, *supra*; 1881, *Telegraph Co. v. Texas*, 105 U. S. 460; 1887, *W. U. Tel. Co. v. Pendleton*, 122 U. S. 347; 1888, *Leloup v. Mobile*, 127 U. S. 640; 1889, *W. U. Tel. Co. v. Alabama*, 132 U. S. 472; 1891, *Matter of Penna. Tel. Co.*, 48 N. J. Eq. 91, 27 Am. St. Rep. 462; 1894, *Postal Tel. & Cable Co. v. Charleston*, 153 U. S. 692.

**Transit or transportation of persons** is interstate intercourse when it crosses state lines: 1867, *Crandall v. Nevada*, 6 Wall. 35; 1875, *Henderson v. Mayor*, 92 U. S. 259; 1877, *Hall v. De Cuir*, 95 U. S. 485; 1882, *People v. Compagnie Generale*, 107 U. S. 59; 1884, *Gloucester Ferry Co. v. Pennsylvania*, 114 U. S. 196; 1903, *Lottery Case*, 188 U. S. 321; 1903, *Kelly v. Rhoads*, 188 U. S. 1.

**Express business**, crossing state lines, is interstate commerce; 1891, *Commonwealth v. Smith*, 92 Ky. 38, 36 Am. St. Rep. 578; 1891, *Crutcher v. Kentucky*, 141 U. S. 47; 1903, *Lottery Case*, 188 U. S. 321.

**Transportation of either persons or property across state lines** is interstate intercourse: 1872, *State Freight Tax Cases*, 15 Wall. 232; 1872, *Osborne v. Mobile*, 16 Wall. 479; 1876, *Council Bluffs v. Kan. City, etc., R.*, 45 Iowa 338, 24 Am. Rep. 773; 1877, *Railroad Co. v. Husen*, 95 U. S. 465; 1885, *Pickard v. Pullman So. Car Co.*, 117 U. S. 34; 1886, *Wabash, etc., R. Co. v. Illinois*, 118 U. S. 557; 1887, *Fargo v. Michigan*, 121 U. S. 230; 1887, *Philadelphia Steamship Co. v. Pennsylvania*, 122 U. S. 326; 1889, *State v. Indiana, etc., Co.*, 120 Ind. 575 (piping oil or gas); 1898, *Kelly v. Rhoads*, 7 Wyo. 237, 75 Am. St. Rep. 904 (driving cattle), affirmed, 188 U. S. 1; 1904, *St. Clair Co. v. Interstate, etc., Co.*, 192 U. S. 454.

But it has been said that traffic passing out of, and back into, a state is not interstate commerce: 1892, *Lehigh Valley R. v. Pennsylvania*, 145 U. S. 192. But the contrary is held as to regulation of rates by a railroad commission: 1903, *Hanley v. Kans., etc., Ry. Co.*, 187 U. S. 617.

(e) *Commencement of this intercourse.*

Such communication, transit or transportation begins, as a matter of interstate commerce, when the message, person, or commodity actually commences to move on its final journey, that is to be continuous until it crosses the state line, and continues till it reaches its destination; if it is to be transmitted by some one engaged in transmitting such things, interstate intercourse begins when the thing is delivered to the carrier, to be by him transmitted or forwarded across state lines, and continues until the carriers engaged have completed the transportation to the place of delivery. It is interstate commerce "when they begin to move from one state to another—the moment in which they begin their final movement on their journey out of the state." It is not interstate commerce "until actually started in course of transportation to the state of their destination, or delivered to the common carrier for that purpose; the carrying of them to and depositing them at a depot for the purpose of transportation is no part of that transportation." 1870, *The Daniel Ball*, 10 Wall. 557; 1886, *Coe v. Errol*, 116 U. S. 517; 1886,



Turpin v. Burgess, 117 U. S. 504; 1891, Bennett v. Am. Ex. Co., 83 Me. 236; 23 Am. St. Rep. 774; 1903, Kelly v. Rhoads, 188 U. S. 1.

(f) *Termination of this intercourse:* The intercourse continues until the person reaches his destination, or until the carrier has completed its functions by delivery at the place of delivery; and in the case of commodities shipped or transported in packages, until the package is broken, or used by the importer, or sold, in its original form, if imported for sale, by him: 1827, Brown v. Maryland, 12 Wheat. 419; 1867, Crandall v. Nevada, 6 Wall. 35; 1871, Carrier v. Gordon, 21 Ohio St. 605; 1884, Gloucester Ferry Co. v. Pennsylvania, 114 U. S. 196; 1884, Brown v. Houston, 114 U. S. 622; 1885, Pickard v. Pullman So. Car Co., 117 U. S. 34; 1888, Pittsburgh & So. Coal Co. v. Bates, 40 La. Ann. 226, 8 Am. St. Rep. 519; 1888, Bowman v. Chicago, etc., R., 125 U. S. 465; 1890, State v. Winters, 44 Kan. 723; 1890, Keith v. State, 91 Ala. 1; 1890, Leisy v. Hardin, 135 U. S. 100; 1890, Lyng v. Michigan, 135 U. S. 161; 1891, State v. Intox. Liq., etc., 83 Me. 158; 1896, Meyers v. County Commissioners, 83 Md. 385, 55 Am. St. Rep. 349; 1899, Fox v. State, 89 Md. 381, 73 Am. St. Rep. 193; 1904, Am. Steel & W. Co. v. Speed, 192 U. S. 500; 1904, State v. Knight, 192 U. S. 21.

But the sale of goods in the original package, by one who purchases from the importer, is not interstate commerce: 1868, Woodruff v. Parham, 8 Wall. 123; 1868, Hinson v. Lott, 8 Wall. 148. Compare, 1899, Hancock v. State, 89 Md. 725.

(g) *What is an original package?* This has been a troublesome question, but the rule as usually stated is: An original package is "such form and size of package as is used by producers or shippers for the purpose of securing both convenience in handling and security in transportation of merchandise between dealers in the ordinary course of actual commerce": 1893, Commonwealth v. Schollenberger, 156 Pa. St. 201, 36 Am. St. Rep. 32, 22 L. R. A. 155; "the bundles as they are put up for transportation, not the single article within the case, box or bale in which they are shipped": 1894, State v. Parsons, 124 Mo. 436, 46 Am. St. Rep. 457; bottles in a sealed paper box, and these shipped in a wooden box, the latter is the original package: 1894, Haley v. State, 42 Neb. 556, 47 Am. St. Rep. 718; cigarettes in paper box containing ten cigarettes sealed and stamped according to the revenue law,—and these small boxes shipped in a box or basket, the box or basket is the original package: 1898, McGregor v. Cone, 104 Iowa 465, 65 Am. St. Rep. 522, 39 L. R. A. 484; 1898, Austin v. State, 101 Tenn. 563, 70 Am. St. Rep. 703; 1900, Austin v. Tennessee, 179 U. S. 343. *Contra*, the paper boxes containing ten cigarettes is the original package: 1897, State v. Goetze, 43 W. Va. 495, 64 Am. St. Rep. 871, and the dissenting opinions of the chief justice and Justices Brewer, Shiras, and Peckham, in Austin v. Tenn., 179 U. S. 343. Mr. Justice Brown, in delivering the opinion of the court in this case, said: "The real question in this case is whether the size of the package in which the importation is actually made is to govern, or the size of the package in which *bona fide* transactions are carried on between the manufacturer and the wholesale dealer residing in different states. We hold to the latter view. \* \* \* Without undertaking to determine what is the proper size of an original package in each case, evidently the doctrine has no application where the manufacturer puts up the package with the express intent of evading the laws of another state, and is enabled to carry out his purpose by the facile agency of an express company, and the connivance of his consignee." This case cites and fully reviews the previous cases; 1903, N. & W. Ry. Co. v. Sims, 191 U. S. 441.

See further: 1827, Brown v. Maryland, 12 Wheat. 419; 1890, State v. Chapman, 1 S. Dak. 414, 10 L. R. A. 432; 1892, Wasserboehr v. Boulier, 84 Me. 165, 30 Am. St. Rep. 344; 1894, State v. Board of Assessors, 46 La. Ann. 145, 49 Am. St. Rep. 318; 1894, Commonwealth v. Paul, 170 Pa. St. 284, 50 Am. St. Rep. 776, 30 L. R. A. 396; 1897, Schollenberger v. Pennsylvania, 171 U. S. 1; 1899, May v. New Orleans, 178 U. S. 496; 1899, Fox v. State, 89 Md. 381, 73 Am. St. Rep. 193; 1903, N. & W. Ry. Co. v. Sims, 191 U. S. 441.

(h) *Corporations organized to engage in interstate commerce.* It is frequently stated that a state can not exclude a corporation organized to engage in interstate or foreign commerce; this, perhaps, is true if the state corporation has

been directly or expressly made an instrument of the national government, or expressly authorized by it, to carry on interstate commerce; but if not so, any state can exclude the corporation from coming into the state without its consent, and establishing a place of business there for anything else than interstate business; it is interference with interstate commerce that is forbidden to the states, and not interference with corporations that are only authorized by other states to enter and do business in the state objecting.

The state creating the corporation has control over it, but not over its interstate commerce; the national government has control over its interstate commerce, but not over the corporation itself otherwise; a foreign state where it seeks to do business has the right to exclude the corporation, but not its interstate commerce. 1876, *Holbert v. St. Louis, K. C. & N. R.*, 45 Iowa 23; 1881, *Chapman v. Pittsburgh S. R. Co.*, 18 W. Va. 184; 1894, *Postal Tel. Co. v. Charleston*, 153 U. S. 692; 1901, *Cargill Co. v. State of Minn.*, 180 U. S. 452. But see *Stockton v. B. & N. Y. R. Co.*, 32 Fed. Rep. 9.

(i) *Railroads, etc.* The U. S. Rev. Statutes provide (section 5258) "that every railroad company in the United States, whose road is operated by steam, is hereby authorized to carry upon and over its road, passengers and freight, troops and mail, on their way from any state to another state, and to connect with roads of other states so as to form continuous lines for the transportation of the same to the place of destination,"—but this shall not "be construed to authorize any railroad company to build any new road or connection with any other road without authority from the state in which such railroad or connection may be proposed. And congress may at any time alter, amend or repeal this section." 1873, *Railroad Co. v. Richmond*, 19 Wall. 584; 1876, *Holbert v. St. Louis, K., etc., R.*, 45 Iowa 23; 1881, *Chapman v. Pittsburgh & S. R. Co.*, 18 W. Va. 184; 1884, *Hardy v. Atchison, etc., R. Co.*, 32 Kans. 698; 1888, *Bowman v. Chicago & N. W. R. Co.*, 125 U. S. 465; 1892, *Norfolk & W. R. Co., v. Commonwealth*, 88 Va. 95; 1895, *In re Debs*, 158 U. S. 564; 1896, *Union Pac. R. v. Chicago, etc., R. Co.*, 163 U. S. 564; 1896, *Hennington v. Georgia*, 163 U. S. 299; 1896, *Illinois Cent. R. v. Illinois*, 163 U. S. 142; 1897, *Gladson v. Minn.*, 166 U. S. 427; 1897, *New York, N. H., etc., R. Co. v. New York*, 165 U. S. 628; 1900, *Wisconsin, M. & P. R. Co. v. Jacobson*, 179 U. S. 287; 1901, *Commrs. v. Mobile & Ohio R. R. Co.*, — Ky. —, 54 L. R. A. 916; 1904, *St. Clair Co. v. Interstate Co.*, 192 U. S. 454; 1904, *State v. Knight*, 192 U. S. 21. Compare *Stockton v. B. & N. Y. R. Co.*, 32 Fed. Rep. 9, *et seq.*

**Sec. 487. (6) Limits on power to exclude,—what is interstate commerce; insurance.**

#### HOOPER v. CALIFORNIA.<sup>1</sup>

1894. IN THE SUPREME COURT OF THE UNITED STATES. 155 U. S. Rep. 648–664.

[Hooper was convicted in the California courts of a misdemeanor for violating a statute of that state making it such an offense "for a person in that state to procure insurance for a resident in the state, from an insurance company not incorporated under its laws," and which had not filed certain bonds required.. Hooper, the agent in California, had, through a New York firm, and upon application of the insured residing in California, procured for him marine insurance on an ocean steamer, from an insurance company incorporated in Mas-

<sup>1</sup> Statement abridged; part of opinion of White, J., and all of dissenting opinion of Harlan, J. (Brewer and Jackson concurring), omitted.

sachusetts, and which had not complied with the laws of California relative to doing business therein. Error was alleged upon the ground that the California statute violated rights under the interstate commerce clause and the fourteenth amendment to the United States constitution.]

MR. JUSTICE WHITE. The principle that the right of a foreign corporation to engage in business within a state other than that of its creation, depends solely upon the will of such other state, has been long settled, and many phases of its application have been illustrated by the decisions of this court. *Bank of Augusta v. Earle*, 13 Pet. 519; *Lafayette Insurance Co. v. French*, 18 How. 404; *Society for Savings v. Coite*, 6 Wall. 594; *Provident Institution v. Massachusetts*, 6 Wall. 611; *Hamilton Co. v. Massachusetts*, 6 Wall. 632; *Pauly v. Virginia*, 8 Wall. 168; *Ducat v. Chicago*, 10 Wall. 410; *State Tax on Railway Gross Receipts*, 15 Wall. 284; *Railroad Co. v. Peniston*, 18 Wall. 5; *Delaware Railroad Tax Case*, 18 Wall. 206; *State Railroad Tax Cases*, 92 U. S. 575; *Philadelphia & Southern Steamship Co. v. Pennsylvania*, 122 U. S. 326; *California v. Central Pacific R. Co.*, 127 U. S. 1; *Home Insurance Co. v. New York*, 134 U. S. 594; *Maine v. Grand Trunk Railway*, 142 U. S. 217; *Ashley v. Ryan*, 153 U. S. 436, 445.

Whilst there are exceptions to this rule, they embrace only cases where a corporation created by one state rests its right to enter another and to engage in business therein upon the federal nature of its business. As, for instance, where it has derived its being from an act of congress, and has become a lawful agency for the performance of governmental or *quasi*-governmental functions, or where it is necessarily an instrumentality of interstate commerce, or its business constitutes such commerce, and is, therefore, solely within the paramount authority of congress. In these cases, the exceptional business is protected against interference by state authority. The reasons upon which the exceptions to the general rule are based have been often explained. *Telegraph Co. v. Texas*, 105 U. S. 460; *Gloucester Ferry Co. v. Pennsylvania*, 114 U. S. 196, 205, 211; *Phila. Steamship Co. v. Pennsylvania*, 122 U. S. 326, 342; *McCall v. California*, 136 U. S. 104, 110; *Norfolk & Western Railroad v. Pennsylvania*, 136 U. S. 114, 118; *Pickard v. Pullman Southern Car Co.*, 117 U. S. 34; *Robbins v. Shelby County Taxing District*, 120 U. S. 489; *Leloup v. Port of Mobile*, 127 U. S. 640; *Asher v. Texas*, 128 U. S. 129; *Stoutenburgh v. Hennick*, 129 U. S. 141; *Crutcher v. Kentucky*, 141 U. S. 47.

In the case last cited the precedents were fully reviewed, and the governing reasons of the law upon the subject were clearly elucidated.

The contention here is that, inasmuch as the contract was one for marine insurance, it was a matter of interstate commerce, and as such beyond the reach of state authority and included among the exceptions to the general rule. This proposition involves an erroneous conception of what constitutes interstate commerce. That the business of insurance does not generically appertain to such commerce

has been settled since the case of *Paul v. Virginia*, 8 Wall. 168. See, also, *Phila. Fire Association v. New York*, 119 U. S. 110, and authorities there cited. \* \* \*

In *Crutcher v. Kentucky*, 141 U. S. 47, the court, in applying the exception to the general rule, held that the state of Kentucky was without power to prevent a corporation engaged in interstate commerce from entering that state and carrying on its business therein, and also pointed out the distinction between the making of contracts of insurance and interstate commerce, or the necessary instrumentalities thereof, as follows: "The case is entirely different from that of foreign corporations seeking to do a business which does not belong to the regulating power of congress. The insurance business, for example, can not be carried on in a state by a foreign corporation without complying with all the conditions imposed by the legislation of that state. So with regard to manufacturing corporations, and all other corporations whose business is of a local and domestic nature, which would include express companies whose business is confined to points and places wholly within the state. The cases to this effect are numerous." Page 59. \* \* \*

The business of insurance is not commerce. The contract of insurance is not an instrumentality of commerce. The making of such a contract is a mere incident of commercial intercourse, and in this respect there is no difference whatever between insurance against fire and insurance against "the perils of the sea."

The state of California has the power to exclude foreign insurance companies altogether from her territory, whether they were formed for the purpose of doing a fire or a marine business. She has the power, if she allows any such companies to enter her confines, to determine the conditions on which the entry shall be made. And, as a necessary consequence of her possession of these powers, she has the right to enforce any conditions imposed by her laws as preliminary to the transaction of business within her confines by a foreign corporation whether the business is to be carried on through officers or through ordinary agents of the company, and she has also the further right to prohibit a citizen from contracting within her jurisdiction with any foreign company which has not acquired the privilege of engaging in business therein, either in his own behalf or through an agent empowered to that end. The power to exclude embraces the power to regulate, to enact and enforce all legislation in regard to things done within the territory of the state which may be directly or incidentally requisite in order to render the enforcement of the conceded power efficacious to the fullest extent, subject always, of course, to the paramount authority of the constitution of the United States. \* \* \*

(After holding that the facts showed that the agent had procured the insurance *within the state*, within the meaning of the statute, proceeds:)

One more contention remains to be noticed. It is said that the right of a citizen to contract for insurance for himself is guaranteed by the fourteenth amendment, and that, therefore, he can not be de-

prived by the state of the capacity to so contract through an agent. The fourteenth amendment, however, does not guarantee the citizen the right to make within his state, either directly or indirectly, a contract, the making whereof is constitutionally forbidden by the state. The proposition that, because a citizen might make such a contract for himself beyond the confines of his state, therefore he might authorize an agent to violate in his behalf the laws of his state, within her own limits, involves a clear *non sequitur*, and ignores the vital distinction between acts done within and acts done beyond a state's jurisdiction.

*Judgment affirmed.*

*Note.* See, 1868, *Paul v. Virginia*, 8 Wall. (U. S.) 168; 1893, *Cone Export, etc., Co. v. Poole*, 41 S. C. 70, 24 L. R. A. 289; 1894, *Ashley v. Ryan*, 153 U. S. 436; 1895, *Seamans v. Temple Co.*, 105 Mich. 400, 55 Am. St. Rep. 457; 1896, *Daggs v. Orient Ins. Co.*, 136 Mo. 382, 58 Am. St. Rep. 638; 1896, *Allgeyer v. Louisiana*, 165 U. S. 579; 1898, *Travelers' Ins. Co. v. Fricke*, 99 Wis. 364, 41 L. R. A. 557; 1898, *Sandall v. Atlantic M. L. Ins. Co.*, 24 S. C. 53, 31 S. E. Rep. 230; 1899, *Manchester Fire Ins. Co. v. Herriott*, 91 Fed. (C. C.) 711. *supra*, p. 1498; 1899, *Orient Ins. Co. v. Daggs*, 172 U. S. 557; 1899, *Cravens v. N. Y. Life Ins. Co.*, 148 Mo. 583, 71 Am. St. Rep. 628; 1900, *Waters-Pierce Oil Co. v. Texas*, 177 U. S. 28; 1901, *John Hancock Mut. L. Ins. Co. v. Warren*, 181 U. S. 73.

**Sec. 488. (7)** Effect of failure to comply with statutory provisions permitting doing business in the state by foreign corporations.

TOLEDO TIE & L. CO. V. W. W. THOMAS.<sup>1</sup>

1890. IN THE SUPREME COURT OF APPEALS OF WEST VIRGINIA.  
33 W. Va. Rep. 566-573.

[Action by the Tie Company, an Ohio corporation, upon a contract for the purchase of ties made in West Virginia. A special plea in abatement alleged that the corporation had not complied with the West Virginia statute before doing business in the state. A demurrer, which was sustained in the lower court, raised the question of the effect of the statute.]

SNYDER, President. \* \* \* Among other provisions the said statute declares, in substance, that any corporation, created by the laws of any state or foreign country, "may, unless it be otherwise expressly provided, hold property and transact business in this state, upon complying with the requirements of this section, and not otherwise." It then requires such corporation to file a copy of its charter with the secretary of state, and file in each county in which it does business a certificate of the secretary of state that it has so filed such copy of its charter in his office; and it further provides, that "Every such corporation, which shall do business in this state, without having complied with the provisions of this section, shall be guilty of a misdemeanor, and upon conviction thereof shall be fined not less than \$500 and not more than \$1,000 for each month its failure so to comply shall continue."

<sup>1</sup> Statement abridged; part of opinion omitted.



In the absence of any statute limiting the right of a corporation to do so, it may, unless contrary to the public policy of the state, hold property and do business without as well as within the state or county by which it was created. Ang. & Ames on Corp., §§ 372-376; Field on Corp., § 363. This statute, being not only in derogation of common law, but penal in its character, must be construed strictly. There is certainly no public policy of this state which is contravened by permitting corporations such as the plaintiff here to do business in the state, because the statute expressly authorizes them to do so upon compliance with its requirements. The evident purpose of these requirements of the statute is to protect parties dealing with foreign corporations from imposition, and to secure convenient means of obtaining jurisdiction in the local courts of the state, and information such as will facilitate the service of process upon such corporations. It is clearly not the primary purpose of the legislature, in passing such statutes, to render the contracts and dealings of such corporations, which have not complied with these requirements, void and unenforceable. Hence the decided weight of authority is, that where the legislature has not expressly declared that this result shall follow from a failure to comply with the statute, the courts ought not to imply such a result, unless this be necessary in order to attain the primary object for which the statute was enacted. Upon this ground it has been held that a contract made by a foreign corporation before it has complied with the statutory prerequisites to the right to do business will not, on that account, be held absolutely void, unless the statute expressly so declares; and if the statute imposes a penalty upon the corporation for failing to comply with such prerequisites, such penalty will be deemed exclusive of any others. *Columbus Ins. Co. v. Walsh*, 18 Mo. 229; *Union, etc., Ins. Co. v. McMillen*, 24 Ohio St. 67; *Ehrman v. Teutonia Ins. Co.*, 1 McCrary 123; *Clay Fire Ins. Co. v. Huron Salt Co.*, 31 Mich. 346; *Hartford, etc., Co. v. Mathews*, 102 Mass. 221; 2 Morawetz on Corp., § 665.

We are aware that the courts of Indiana, Illinois, Wisconsin, and perhaps in some other states, hold a different doctrine. In Vermont and Oregon it has been held that a non-compliance with the precedent conditions of the statutes of those states by foreign corporations rendered their contracts void. But it will be observed that these statutes imposed no penalty for the failure to comply with their provisions; and it is principally upon this ground that the contracts are held void, because otherwise the statute might be evaded with impunity. Thus in *Bank v. Page*, 6 Ore. 431, 436, the court says: "The general rule is that a contract in violation of law is void. The only exception to the rule is that when a law imposes a penalty for the prohibited act, and it clearly appears that the legislature intended no more than to impose the penalty for the violation of the law, a contract made in violation of the statute is not void." It is evidently the want of such penalty in the statute that influenced the court to hold the contract void. And such seems to be the ground of the decisions in Indiana and other states. *Mowing, etc., Co. v. Caldwell*, 54 Ind. 273; *Lester v. Howard Bank*, 33 Md. 558.



The authorities on this question are reviewed in 2 Morawetz on Corp., sections 662-666, and that author announces as his conclusion therefrom, that "Unless it appear affirmatively that the legislature intended to render the forbidden act or contract absolutely void in legal contemplation, it will not be so held," citing *Nat. Bank v. Mathews*, 98 U. S. 621, 627.

Let us apply these principles to our statute. The first provision is that the foreign corporation may do business in this state "upon complying with the requirements of this section, and not otherwise." It next declares, that such corporation so complying shall have the same rights and privileges and be subject to the same liabilities as domestic corporations. And it finally imposes a penalty upon such corporation for its failure to comply with the regulations of the statute. There is here no express declaration that the failure to comply shall render the contracts of the corporation absolutely void. Nor does it affirmatively appear that the legislature so intended. But it is expressly provided and declared, that a failure to comply with the regulations prescribed shall be punished by fine. And this imposition of a penalty, as we have seen, in the absence of any express declaration to the contrary, must be held to be exclusive of all other penalties. That such was the purpose of the legislature in enacting this statute is manifest from the provision therein in respect to railroad corporations. It prescribes additional regulations for such companies, and declares that unless they are complied with such companies shall not maintain any action or suit in this state. The whole section shows no purpose to treat railroad corporations with more favor than other corporations, yet if we hold the contracts of all other corporations absolutely void, while only denying to railroad companies the right to sue in our courts, the effect would be to discriminate in favor of the latter. Upon the whole, I am of opinion that the court did not err in sustaining the demurrer to said second special plea. \* \* \*

*Affirmed.*

*Effect of failing to comply with statute:*

(1) When there is a penalty:

(a) The contract is void: 1831, *Pennington v. Townsend*, 7 Wend. 276; 1841, *New Hope Del. B., etc., Co. v. Poughkeepsie S. Co.*, 25 Wend. 648; 1860, *Aetna Insurance Co. v. Harvey*, 11 Wis. 394; 1869, *Ford v. Buckeye, etc., Co.*, 6 Bush (Ky.) 133, 99 Am. Dec. 663; 1870, *Cincinnati Mut. H. Assoc. v. Rosenthal*, 55 Ill. 85, 8 Am. Rep. 626; 1876, *Stewart v. Northampton, etc., Co.*, 38 N. J. L. 436; 1879, *Mutual Ben. L. Ins. Co. v. Bales*, 92 Pa. St. 352; 1881, *American Ins. Co. v. Smith*, 73 Mo. 368; 1888, *Dudley v. Collier*, 87 Ala. 431 (reviews cases); 1890, *Boulden v. Estey Organ Co.*, 92 Ala. 182; 1891, *Dundee M. & T. Inv. Co. v. Nixon*, 95 Ala. 318; 1893, *Cary-Lombard Lumber Co. v. Thomas*, 92 Tenn. 587; 1895, *Seamans v. Temple Co.*, 105 Mich. 400, 55 Am. St. Rep. 457; 1901, *Henni v. Fidelity B. & L. Assn.*, 61 Neb. 744, 87 Am. St. R. 519; 1903, *Chattanooga, etc., Bldg. Assn. v. Denson*, 189 U. S. 408.

(b) Contracts are not void: 1853, *Clark v. Middleton*, 19 Mo. 53; 1859, *Merrill v. McIntire*, 13 Gray 157, 165; 1873, *The Manistee*, 5 Biss. 381; 1877, *Manhattan Ins. Co. v. Ellis*, 32 Ohio St. 388; 1881, *King v. National M. & E. Co.*, 4 Mont. 1; 1889, *Fritts v. Palmer*, 132 U. S. 282; 1890, *Toledo Tie & L. Co. v. Thomas*, 33 W. Va. 566, *supra*; 1894, *Edison Gen. El. Co. v. Canada, etc., Co.*, 8 Wash. 370, 24 L. R. A. 315; 1895, *State, etc., Ins. Assn. v. Brinkley, etc., Co.*, 61 Ark. 1, 54 Am. St. Rep. 191; 1896, *Pioneer Sav. & L. Co. v. Cannon*, 96 Tenn. 599, 54 Am. St. Rep. 858; 1898, *Turcott v. Railroad*, 101 Tenn. 102, 70 Am. St. Rep. 661; 1899, *Security Sav. & L. Assn. v. Elbert*, 153

Ind. 198, 54 N. E. Rep. 753; 1899, *Sullivan v. Sheehan*, 89 Fed. Rep. 247; 1899, *Wolff Dryer Co. v. Bigler*, 192 Pa. St. 466.

(2) When there is no penalty: (a) Contract is void or voidable: 1866, *The Pres., etc., Bank of Louisville v. Young*, 37 Mo. 398; 1873, *Franklin Ins. Co. v. Louisville, etc., Co.*, 9 Bush (Ky.) 590; 1874, *In re Comstock*, 3 Sawy. 218; 1877, *Bank of British Col. v. Page*, 6 Ore. 431; 1879, *Am. Ins. Co. v. Stoy*, 41 Mich. 385, on 401; 1883, *Lycoming F. Ins. Co. v. Wright*, 55 Vt. 526; 1885, *Hackeny & Beno v. Leary*, 12 Ore. 40; 1887, *Barbor v. Boehm*, 21 Neb. 450; 1889, *Am. L. & T. Co. v. East & W. R. Co.*, 37 Fed. Rep. 242.

(b) Contract is not void: 1889, *Fritts v. Palmer*, 132 U. S. 282.

**Sec. 489. (8) What is "doing business" in violation of such statutes?**

**FLORSHEIM BROS. DRY GOODS CO. v. LESTER.<sup>1</sup>**

1892. IN THE SUPREME COURT OF ARKANSAS. 60 Ark. Rep. 120-124, 46 Am. St. Rep. 162.

[Suit to foreclose a mortgage given by Lester in Arkansas upon land in that state to secure the payment of \$1,600 due to the Dry Goods Company, a Louisiana corporation, for goods sold in Louisiana to Lester upon credit. The constitution and laws of Arkansas provided that no foreign "corporation shall do any business in this state" without a known place of business and an authorized agent in the same upon whom process may be served, and which, before "it shall begin to carry on business in the state," shall be designated by filing a "certificate with the secretary of state." The defense made was the non-compliance with these provisions. A demurrer to this defense was overruled.]

HUGHES, J. The only question in this case is whether the taking of a single mortgage in this state, by a foreign corporation, for a past-due indebtedness for goods sold in the foreign state, the domicile of the foreign corporation, is doing business in this state, within the meaning of the constitution and the act of the general assembly above quoted. There can be no doubt that the sale and shipment of the goods was interstate commerce. It does not matter, then, how many sales and shipments there might have been; they could not be prohibited by the statute. There is no evidence that more than one mortgage was taken by the appellant in this state. Was the taking of this mortgage doing any business prohibited by the laws of this state to be done by a foreign corporation before complying with the provisions of the constitution and statute referred to? If so, the mortgage can not be enforced in the courts of this state; for, if a single act of business be done by a foreign corporation in this state, within the meaning of these provisions of the law, it is as much within the prohibition contained in them as any number of acts of business would be. But we are of opinion that the taking of a single mortgage to secure a past-due debt, with no intention apparent to transact other business of the kind in the state, is not doing business within the meaning of the constitution or the statute.

<sup>1</sup> Statement abridged, arguments and small part of opinion omitted.

There is a division of authorities on this question. But we think the better view of the question is presented in *Cooper Manufacturing Co. v. Ferguson*, 113 U. S. 727, in which the court said: "Reasonably construed, the constitution and statute of Colorado forbid, not the doing of a single act of business in the state, but the carrying on of business by a foreign corporation without the filing of the certificate and the appointment of an agent, as required by the statute. The constitution requires the foreign corporation to have one or more known places of business in the state before doing any business therein. This implies a purpose at least to do more than one act of business. For a corporation that has done but a single act of business, and purposes to do no more, can not have one or more known places of business in the state. To have known places of business, it must be carrying on or intending to carry on business. The statute passed to carry the provision of the constitution into effect makes this plain, for the certificate which it requires to be filed by a foreign corporation must designate the principal place in the state where the business of the corporation is to be carried on. The meaning of the phrase, 'to carry on,' when applied to business, is well settled. In Worcester's Dictionary, the definition is: 'To prosecute, to help forward, to continue, as to carry on business,' etc. \* \* \* The obvious construction, therefore, of the constitution and the statute is that no foreign corporation shall begin any business in the state, with the purpose of pursuing or carrying it on, until it has filed a certificate designating the principal place where the business of the corporation is to be carried on in the state, and naming an authorized agent, residing at such principal place of business, on whom process may be served. To require such a certificate as a prerequisite to the doing of a single act of business, when there was no purpose to do any other business, or have a place of business in this state, would be unreasonable and incongruous." \* \* \*

*Reversed.*

See next case.

*Note.* What is doing business in the state.

(a) *Tests:* In *Commonwealth v. Long*, 1 Pa. Co. Ct. 190, McPherson, J., says the test is "whether the acts done were part of the necessary work for effecting the object for which the association was created." Or, as said in *Beard v. Publishing Co.*, 71 Ala. 60: "There must be a doing of some of the works, or an exercise of some of the functions, for which the corporation was created."

(b) *Illustrations:* 1881, *Beard v. Union Am. Pub. Co.*, 71 Ala. 60 (soliciting and receiving subscriptions to a foreign newspaper is not exercising corporate franchise in the state); 1885, *Commonwealth v. Long*, 1 Pa. Co. Ct. Rep. 190 (mailing letters and circulars by an agent, soliciting insurance, is doing business in the state); 1885, *Cooper v. Ferguson*, 113 U. S. 727, *supra* (filling an order and setting up machinery is not doing business in the state); 1894, *Milan, etc., Co. v. Gorten*, 93 Tenn. 590, 26 L. R. A. 135 (same); 1889, *Christian v. Am. F. L. & Mtg. Co.*, 89 Ala. 198 (suing is not doing business in the state); 1890, *Ginn v. N. E. Mtg. Co.*, 92 Ala. 135; 1891, *Dundee Mtg., etc., Co. v. Nixon*, 95 Ala. 318; 1895, *State v. Bristol Sav. Bk.*, 108 Ala. 3, 54 Am. St. Rep. 141 (making a loan and taking a note or mortgage by a loan company is doing business in the state); 1895, *Commercial Bank v. Sherman*, 28 Ore. 573, 52 Am. St. Rep. 811 (purchase of a note is not); 1895, *Bamberger*

v. Schoolfield, 160 U. S. 149, on 167 (sending a note into a state for collection is not doing business there); 1902, Buffalo Zinc Co. v. Crump, 70 Ark. 525, 91 Am. St. R. 87.

See, also, 1888, Kilgore v. Smith, 122 Pa. St. 48; 1889, Commonwealth v. Am. Bell Tel. Co., 129 Pa. St. 217; 1891, State v. Ray, 109 N. C. 736, 14 L. R. A. 529; 1892, Penna. Co. v. Bauerle, 143 Ill. 459; 1899, Delaware & H. Canal Co. v. Mahlenbrock, 63 N. J. 281, 45 L. R. A. 538.

## Sec. 490. Same.

### FARRIOR v. NEW ENGLAND MORTGAGE SECURITY CO.<sup>1</sup>

1889. IN THE SUPREME COURT OF ALABAMA. 88 Ala. Rep. 275-280.

[Bill by the security company, a Massachusetts corporation, to foreclose a mortgage upon land in Alabama belonging to Farrior, given there to secure the payment of a note for \$5,500.00. The defendant demurred upon the ground that the bill did not show that at the time the note and mortgage were executed the company had a resident agent and a known place of business within the state, the constitution of which, section 4, article XIV, provided that "no foreign corporation shall do any business in this state, without having at least one known place of business, and an authorized agent or agents therein." Overruling the demurrer is the error assigned.]

SOMERVILLE, J. \* \* \* The bill alleges that the complainant corporation, "under its charter and laws of incorporation, had full power and authority" to loan the money and take the mortgage in controversy. In engaging in such a transaction, the complainant was in the exercise of its chief corporate function, as imported by its very name, and as admitted by the bill. The prohibition of the constitution is against "doing *any* business in this state," without compliance with the conditions specified. The doing of a single act of business, if it be in the exercise of a corporate function, is as much prohibited as the doing of a hundred such acts; and it is just as much opposed to the policy of the constitution, which is to protect our citizens against the fraud and imposition of insolvent and unreliable corporations, and to place them in an attitude to be reached by legal process from our courts, in the event of any existing necessity to bring suit against them to vindicate a legal right, or to contest the validity of any contract made by or with them. The phrase, "doing *any* business," is more comprehensive in meaning than the carrying on or engaging in business generally, which involves the idea of continuance, or the repetition of like acts. All the adjudged cases, so far as we have examined, in and out of this state, assume this to be true, except the case of Cooper Man. Co. v. Ferguson, 113 U. S. 727; 2 Morawetz on Corp. (2d ed.), sections 661-665, and cases cited. There it was said, that a clause in the constitution of Colorado, like the one here under consideration, was not to be construed to prohibit a single act, but only "the *carrying on* of business" by a foreign corporation. The act there done was the making of a contract in Colorado, to

<sup>1</sup>Statement abridged, part of opinion omitted.

manufacture certain machinery in Ohio, to be delivered in the latter state for transportation to the purchasers in the former. The promise was a mere agreement to deliver goods in another state, and possibly was not the unlawful exercise of a corporate function. *Beard v. Union & Amer. Pub. Co.*, 71 Ala. 60. However that may be, we do not concur in the construction given, in which, also, two of the judges of the court rendering the decision, it seems, did not agree. Their concurrence in the judgment was placed solely on the ground that the prohibition contained in the Colorado constitution, when directed against a sale of that character, would be an attempted regulation of commerce between the states, and on this account void for repugnancy to the federal constitution. \* \* \*

*Reversed.*

*Note.* See note to preceding case; also, 1903, *Chattanooga Bldg. & L. Assn. v. Denson*, 189 U. S. 408.

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**Sec. 491. Same.** Owning and using real estate by a foreign corporation.

THE PENNSYLVANIA COMPANY FOR INSURANCE ON LIVES, Etc.,  
v. BAUERLE.<sup>1</sup>

1892. IN THE SUPREME COURT OF ILLINOIS. 143 Ill. Rep. 459-480.

[Bill in equity for specific performance of a contract of sale of land by the insurance company (a Pennsylvania corporation) trustee, and the executors of one S., deceased, to whom the decedent devised certain land in Illinois, with power of sale, against Bauerle. Section 26 of the corporation law (1 Starr & C., ch. 32, par. 32) and the laws relating to trust companies provided that foreign corporations of this kind doing business in the state must first deposit \$200,000 in stock and bonds specified and secure a certificate of authority from the auditor of public accounts,—and it should not be lawful for any such company to accept such trust before doing so. The company had not complied with these provisions when the deed tendered by it to Bauerle was executed. A demurrer to the bill was sustained by the lower court.]

MR. JUSTICE BAKER. \* \* \* In *Female Academy v. Sullivan*, 116 Ill. 375, this court, referring to said section 26, says: "As the section reads, foreign corporations 'doing business in this state,' it is said this corporation is not embraced therein, as it is not doing business in this state. Receiving lands in this state by devise, and the assertion in the state of ownership over them, we regard as a sufficient doing of business in this state to bring appellant within the purview of this language of the section." So here, receiving the land adjoining Chicago by devise, with power to sell and dispose of the same, and with power to lease it and to collect the rents and profits therefrom, and the assertion in this state of the ownership of said land,

<sup>1</sup> Statement abridged; only that part of opinion relating to the single point is given.

and assuming to sell and convey it, and bringing suits in the courts of this state in respect to said land and such alleged ownership, and for the enforcement of contracts in regard to the same, must be held to be doing business in this state, within the purview of said section. \* \* \*

*Affirmed.*

*Note.* A corporation can not hold land in another state unless that state consents: 1840, Runyan v. Coster, 14 Pet. 122; 1872, Thompson v. Waters, 25 Mich. 214, 12 Am. Rep. 243; 1873, Carroll v. E. St. Louis, 67 Ill. 568, 16 Am. Rep. 632; 1874, U. S., etc., Co. v. Lee, 73 Ill. 142, 24 Am. Rep. 236; 1879, Cowell v. Colorado, etc., Co., 100 U. S. 55; 1883, Diamond, etc., Co. v. Powers, 51 Mich. 145; 1886, Commonwealth v. N. Y. & L. E. R., 114 Pa. St. 340; 1890, Commonwealth v. N. Y., L. E. & W. R., 132 Pa. St. 591, 7 L. R. A. 634; 1894, Lancaster v. Amsterdam, etc., Co., 140 N. Y. 576, 24 L. R. A. 322, with note; 1903, Southern Illinois, etc., Bridge Co. v. Stone, 174 Mo. 1, 63 L. R. A. 301.

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**Sec. 492. (9) Statutes discriminating against non-resident corporations as creditors.**

See Blake v. McClung, 172 U. S. 239, *infra*, p. 2036; Blake v. McClung, 176 U. S. 59, *infra*, p. 2045.

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**ARTICLE III. VISITORIAL POWER OVER FOREIGN CORPORATIONS.**

**Sec. 493. (1) Forfeiture of charter.**

See State of Connecticut, etc., v. Curtis, 35 Conn. 374, *supra*, p. 258.

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**Sec. 494. (2) To oust from the state.**

**DICKINSON, J., IN STATE, EX REL. ATTORNEY-GENERAL, v. FIDELITY AND CASUALTY INSURANCE COMPANY.<sup>1</sup>**

1888. IN THE SUPREME COURT OF MINNESOTA. 39 Minn. Rep. 538, 41 N. W. Rep. 108.

This is a proceeding upon information in the nature of *quo warranto* to try the right of the above-named respondent, a corporation of the state of New York, to carry on within this state the business of insurance against these three classes of risks, viz.: injury or death of persons caused by accident, breach of trust by persons holding places of public or private trust, and the breakage of plate-glass. The case is presented for decision upon the relator's demurrer to the

<sup>1</sup> Only that part of opinion relating to ouster, and to review of the license of the insurance commissioner, is given.



answer of the respondent. It is contended on the part of the respondent that this is not an appropriate method of procedure. We hold the contrary. A state has the power of a sovereign to prohibit foreign corporations from exercising their franchises, carrying on their ordinary corporate business, within its borders; and when, in defiance of such prohibition, and contrary to our law, a foreign corporation does assume to exercise corporate franchises in a manner affecting the public interests, *quo warranto* will lie for the purposes of determining the right in question, and of applying a remedy, although it is true that the courts of a state have no power to affect by their judgments the corporate existence of foreign corporations. We can restrain the exercise, within our own jurisdiction, of corporate franchises inconsistent with our own sovereignty, whether the corporation whose acts are in question be domestic or foreign. *State v. Railroad Co.*, 25 Vt. 433. And see *People v. College*, 5 Wend. 211. It is said on the part of the respondent that we ought not to entertain the proceeding because the determination of the question whether it should be licensed and admitted to transact its business in this state is committed by law to a branch of the executive department of the state, and that the judicial department of the state has no constitutional control over the action of the executive department. In this the counsel for respondent fail to distinguish between the authority of the judicial department to control the action of executive officers, and the power and duty of the courts to determine, in causes before them, the rights of parties, although the legal propriety and effect of the action of executive state officers may necessarily be thus brought in question. We have assumed, without so deciding, that the insurance commissioner, in respect to the discharge of his duties, is exempt from judicial control.

The insurance commissioner, in granting certificates or licenses to foreign corporations to do business here, acts in a ministerial capacity. His determination and action are not judicial and final. If our statute, to be hereafter recited, prohibits foreign corporations, under certain circumstances, to do business in this state, the authority or license of the commissioner in disregard of that statute would be unavailing.

(Discussion as to the meaning and extent of the Minnesota retaliatory law, and the effect of the New York laws,—holding that, unless it clearly appeared that these would exclude Minnesota companies from doing business in New York, the New York Company would not be ousted from doing business in Minnesota,—is omitted.)

**Sec. 495.** (3.) In general, there is no visitorial power over foreign corporations.

(a) Reinstatement of member.

**THE NORTH STATE COPPER AND GOLD MINING CO. v. FIELD.<sup>1</sup>**

1885. IN THE COURT OF APPEALS OF MARYLAND. 64 Md. Rep. 151-156.

[Application by Field, a citizen of Maryland, for mandamus to reinstate him as a stockholder in the Mining Company, a South Carolina corporation having an office and transacting business in Maryland. Field's stock was forfeited by the directors for non-payment of an assessment made by them upon each stockholder, which assessment Field alleged to be illegal and void. The defense of the corporation was that the courts of Maryland had no jurisdiction over it in a matter of this kind. A demurrer to this defense was sustained and an appeal taken.]

STONE, J. \* \* \* The act of 1868, chapter 471, section 209, provides that "Any corporation not chartered by the laws of this state, which shall transact business therein, shall be deemed to hold and exercise franchises within this state, and shall be liable to suit in any of the courts of this state, on any dealings or transactions therein."

And in a subsequent section the law provides:

"Suits may be brought in any court of this state, or before a justice of the peace, against any corporation not incorporated under its laws, but deemed to hold and exercise franchises therein, or against any joint stock company or association doing business in this state, *for* any cause of action; and by a plaintiff, not a resident of this state, when the cause of action has arisen, or the subject of the action shall be situated in this state."

The object of our statute, and of similar statutes passed by other states, is to provide for the collection of debts due from foreign corporations to our own citizens, and to enforce contracts made here by foreign corporations through its agents, and to protect our citizens from frauds or wrong, whether the wrongdoer be foreign or domestic.

But it was not the intent of our statute to give our courts jurisdiction over the *internal* affairs of a foreign corporation. Our courts possess no visitorial power over them, and can enforce no forfeiture of charter for violation of law, or removal of officers for misconduct; nor can they exercise authority over the corporate functions, the by-laws, nor the relations between the corporation and its members, arising out of, and depending upon, the law of its creation. These powers belong only to the state which created the corporation.

In the case of *Wilkins v. Thorne*, 60 Md. 253, this court said:

"This is clearly a controversy relating to the *internal* management of the corporation, and the validity of the acts of those who claim to be, and indeed are admitted to be, *de facto*, its officers and stock-

<sup>1</sup> Statement abridged, and small part of opinion omitted

holders. Now, if this were a Maryland corporation, there could be no question as to the jurisdiction of a Maryland court over the subject, but such is not the case. The corporation was created by the laws of another state; and it seems to us that all such controversies must be determined by the courts of the state by which the corporation was created."

Thorne's Case was a controversy between *bona fide* stockholders of a corporation on the one side, and those claiming to be stockholders, and the president and directors on the other; and such a controversy was said by this court to be a controversy about the internal management of the corporation.

It may not be in all cases easy to draw a clear line of distinction between the acts of a corporation relating to its internal management and those which do not. But we apprehend the distinction to be this: That where the act complained of affects the complainant solely in his capacity as a member of the corporation, whether it be as stockholder, director, president, or other officer, and is the act of the corporation, whether acting in stockholders' meeting, or through its agents, the board of directors, that then such action is the management of the internal affairs of the corporation, and in case of a foreign corporation, our courts will not take jurisdiction. Where, however, the act of the foreign corporation complained of affects the complainant's individual rights only, then our courts will take jurisdiction whenever the cause of action arises here.

The controversy in the case before us arises entirely out of the internal management of the affairs of the company. It is the complaint of a *stockholder*, that he has been deprived of his rights *as a stockholder* by the illegal action of the board of directors. His complaint is that he is still a stockholder, and a member of the corporation, and entitled to his vote at the stockholders' meeting, etc., but that these rights have been withheld from him by the action of the directors, and he seeks to be reinstated as a member of a foreign corporation by the action of a Maryland court. He seeks this through the extraordinary remedy of a *mandamus*, to compel the board of directors to place on their books his name as a stockholder, and thus to restore him to all the rights of a member of the corporation, which the directors say he had forfeited.

In *Howell v. Chicago and Northwestern Railway Co.*, 51 Barbour 378, the supreme court of New York refused to restrain the company from paying a stock dividend, upon the ground that the company had no authority to declare such a dividend, for the reason that the courts of one state would not undertake to regulate the *internal affairs* of a foreign corporation, and refused to investigate the question whether the dividend was rightfully or wrongfully declared.

The case of *Stafford & Co. v. American Mills Co.*, 13 Rhode Island 310, was a petition to appoint a receiver for a New York corporation in Rhode Island. It was shown that two out of the three stockholders who constituted the corporation resided in Rhode Island, and that much the larger part of the corporate property was located

in Rhode Island. The corporation entered an appearance, and submitted to the jurisdiction of the court. But the court dismissed the petition, and refused to entertain jurisdiction, because such jurisdiction was not conferred by their statute.

*Redmond v. Enfield Manufacturing Company*, 13 Abbott's Practice Reports (N. S.) 332, was a case where a stockholder attempted to compel a foreign corporation to divide the assets among the stockholders, and the court said:

"To attempt, by a judgment of this court, to compel a foreign corporation to distribute its assets among the stockholders, because some of the directors were resident here, or because some of the funds were within the jurisdiction of the court, would be assuming a power which the court ought not to exercise, and rendering a judgment which could not be enforced against the company in the place of its existence."

Being of opinion that the legislature did not contemplate or intend, by the passing of the statute we have quoted, to give to our courts jurisdiction and power to regulate the merely internal affairs of a foreign corporation, and as our courts clearly possess no such power unless conferred upon them by statute, we must reverse the order appealed from, and dismiss the petition. \* \* \*

*Reversed.*

*Note. Accord:* 1867, *Smith v. Mut. L. Ins. Co.*, 14 Allen (Mass.) 336; 1883, *Kansas & E. R. Const. Co. v. Topeka, etc.*, 135 Mass. 34; 1883, *Wilkins v. Thorne*, 60 Md. 253; 1889, *Moore v. Mining Co.*, 104 N. C. 534, 10 S. E. Rep. 679; 1892, *Kimball v. St. Louis, etc., R. Co.*, 157 Mass. 7, 34 Am. St. Rep. 250; 1893, *In re Estate of Prime*, 136 N. Y. 347, 18 L. R. A. 713; 1893, *Republican M. S. M. v. Brown*, 58 Fed. (C. C. A.) 645, 24 L. R. A. 776, note; 1894, *Guilford v. W. U. Tel. Co.*, 59 Minn. 332, *infra*, p. 1521; 1896, *National Tel., etc., Co. v. DuBois*, 165 Mass. 117, 52 Am. St. Rep. 503; 1897, *Madden v. Light Co.*, 181 Pa. St. 617, 38 L. R. A. 638; 1899, *Clark v. Mut. Res. F. L. A.*, 14 App. D. C. 154, 43 L. R. A. 390; 1899, *Condon v. Mut. Res. F. L. A.*, 89 Md. 99, 73 Am. St. Rep. 169, 42 Atl. Rep. 944; 1899, *Taylor v. Mut. Res. F. L. A.*, 97 Va. 60, 33 S. E. Rep. 385; 1899, *Howard v. Mut. Res. F. L. A.*, 125 N. C. 49, 45 L. R. A. 853, 34 S. E. Rep. 199; 1902, *Williams v. Gaylord*, 186 U. S. 157.

**Sec. 496. Same. (b) To compel issue of certificate of stock.**

**GUILFORD v. WESTERN UNION TELEGRAPH COMPANY.<sup>1</sup>**

1894. IN THE SUPREME COURT OF MINNESOTA. 59 Minn. Rep. 332-347, 50 Am. St. Rep. 407.

[Appeal by Guilford from decision of lower court denying the relief sought. The action was brought to have the plaintiff adjudged the owner of certain shares of the stock of the defendant company, and to compel the company to issue to him new certificates therefor in place of the originals, which were alleged to have been lost for more than

<sup>1</sup> Statement abridged, arguments and part of opinion omitted.

twelve years, and, if the defendant refuses to issue the same, that plaintiff have judgment against it for the value of the stock. It is not questioned but that plaintiff, a citizen of this state, is the owner of the stock. The certificates are alleged to have been lost. The defendant has always been willing to issue to plaintiff new certificates on condition that he first execute to it a bond with two sureties in double the amount of the value of the stock (over \$35,000) to indemnify it against the original certificates in case they should turn up in the hands of a third party. This condition the plaintiff has been unable to comply with. The defendant is a corporation organized under the laws of the state of New York, where its principal place of business is located, and where all its general officers reside, and where all its stock and other books are kept. The only business transacted by it in this state is the maintenance of telegraph lines and the transmission of telegrams, for which purpose exclusively it has local agents here.]

MITCHELL, J. \* \* \* The defendant, both in its answer and on the argument, makes its point (not raised on the appeal in the former action) that the courts of this state have no jurisdiction of the subject-matter of the action, because it pertains solely to the management of the internal affairs of a foreign corporation. The doctrine is well settled that courts will not exercise visitorial powers over foreign corporations, or interfere with the management of their internal affairs. Such matters must be settled by the courts of the state creating the corporation. This view rests upon a broader and deeper foundation than the mere want of jurisdiction in the ordinary sense of that word. It involves the extent of the authority of the state (from which its courts derive all their powers) over foreign corporations. The only difficulty is in drawing the line of demarkation between matters which do and those which do not pertain to the management of the internal affairs of a corporation. To entertain an action to dissolve a corporation; to determine the validity of its organization; to determine which of two rival organizations is the legal one, or who of rival claimants are its legal officers; to restrain it from declaring a dividend, or to compel it to make one; to restrain it from issuing its bonds, or from making an additional issue of stock,—would clearly all be the exercise of visitorial powers over the corporation, or an interference with the management of its internal affairs. \* \* \* (Citing and commenting on *Smith v. Insurance Co.*, 14 Allen 336, and *Mining Co. v. Field*, 64 Md. 151, *supra*, p. 1519.) There is no controversy as to the right of the plaintiff to a certificate as evidence of his title. The only dispute is over the terms or conditions upon which that certificate shall be issued. We do not see how the granting of such relief is, in any proper sense, the exercise of visitorial powers, or an interference with the management of the internal affairs of the defendant. Statements are sometimes found to the effect that where the act of the corporation complained of affects a person solely in his capacity as a member of the corporation, or where the rights of a person grow solely out of his membership in the corporation, and not out of some external transaction, the subject relates to the manage-

ment of the internal affairs of the corporation, over which the courts of another state should not assume jurisdiction. Such general statements must always be construed in connection with the particular facts of the cases in which they are used. Moreover, such statements are not strictly correct as abstract propositions in the broad and unqualified sense in which they are sometimes understood. We think there are cases, and that this is one of them, where, although the rights of a party grow out of his membership in the corporation, yet, as the matter affects only his individual rights under the contract by which the stock was issued, therefore an enforcement of those rights will not be an interference with the internal management of the corporate affairs within the meaning of the rule.

If upon principles of law or comity foreign corporations are allowed to do business and maintain suits in another state, the general rule should be that they are liable to be sued in the same jurisdiction. Their rights and liabilities in that regard ought to be reciprocal. If we recognize their existence for one purpose, we ought also for the other. If our courts admit and vindicate their rights, justice requires that we also enforce their liabilities, and that, before we send our own citizens to a foreign jurisdiction for redress, it should be very clear that the subject of the action is beyond the limits of the power or sovereignty of the state over the foreign corporation. If a citizen of this state held a certificate of stock in a foreign corporation, which was alleged to have been illegally issued, or to have for some cause become forfeited, we do not think there would be any doubt but that our courts would entertain a suit by the corporation to compel its surrender and cancellation. If so, why ought not a citizen of the state be allowed to maintain an action to compel the issue to him, as evidence of his title, of a new certificate in place of one that has been lost or destroyed? It is urged that if the courts of this state entertain jurisdiction of such a case they may impose different conditions upon the issue of the certificate from those that might be imposed by the courts of New York or of other states under the same state of facts. This must be conceded. It is one of the necessary imperfections in the administration of justice that courts of different, and even of the same, jurisdictions will differ as to the law applicable to the same state of facts. But it was never heard that this of itself was any reason why a court should not exercise jurisdiction. It is also contended that the courts of this state ought not to entertain the action because they have no means to enforce their decree by compelling the issue of a certificate. It is undoubtedly true that courts will not entertain an action where it is apparent that if a judgment was rendered they would be wholly unable to enforce it. But the mere fact that they may be unable to compel specific performance in a particular way is no reason why the suit should not be entertained. If the defendant should refuse to issue certificates in accordance with the judgment, it would be entirely competent for the court, in accordance with the prayer of the complaint, to render judgment for the value of the stock. Our conclusion is that the action can be maintained. \* \* \*



(After holding that certificates of stock were not negotiable, that they were only evidence of title, and were not a representation that any one but the one to whom they were issued was the owner, and that if they should be found in the hands of another claimant, he would be estopped by laches in not claiming dividends for twelve years,—the cause was remanded to court below to give judgment for plaintiff.)

*Note.* See note to preceding case.

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**Sec. 497. Same. (c) To compel inspection of books.**

See *In Matter of Rappleye*, 43 App. Div. 84, *infra*, p. 1651; *Houston, J.*, in *Richardson v. Swift*, 7 Houst. 137, *infra*, p. 1653.

*Note.* See note to section 495, *supra*.

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**Sec. 498. (4) Receivers in state courts.**

HENRY E. IRWIN v. THE GRANITE STATE PROVIDENT ASSOCIATION.<sup>1</sup>

1897. IN THE COURT OF CHANCERY OF NEW JERSEY. 56 N. J. Eq. 244-251.

[The Association, a New Hampshire corporation, sold shares and made loans in many states, including New Jersey, Irwin being one of the New Jersey shareholders. In 1896 the company became insolvent, and one Taggart was appointed assignee in New Hampshire. Irwin filed his bill in New Jersey alleging the insolvency and appointment of an assignee in New Hampshire, and asked for a receiver,—one Gray being appointed. Upon petition, Taggart was afterward made a defendant, and filed his bill, alleging that as assignee he was entitled to all the assets in New Jersey, asked that he be substituted for Gray as receiver, and that the latter be required to follow the directions of Taggart and pay over to him all sums collected.]

REED, V. C. Assuming that Mr. Taggart, at this stage of the suit, is in a position to question the appointment of the New Jersey receiver, I am of the opinion that there is no substance in the objections raised. The insistence made on this behalf is, that all right in the assets of the insolvent corporation passed to him by force of his appointment as assignee in the state of New Hampshire. This proposition undoubtedly states the general rule. The right to collect personal assets everywhere passed to the receiver, but the exercise of that right beyond the limits of the state of his appointment is by virtue of

<sup>1</sup> Statement abridged; part of opinion omitted.

the comity which may be extended to him by the court of the state in which the right is asserted. This comity will not be extended where the rights of the citizens of the state are likely to be prejudiced or where it would be in contravention of the policy of the state. *Hurd v. Elizabeth*, 12 Vr. 1; *National Trust Co. v. Miller*, 6 Stew. Eq. 155; *Sobernheimer v. Wheeler*, 18 Stew. Eq. 614.

In view of this admitted rule it follows, I think, that whenever application is here made for an appointment of a receiver for a foreign corporation which is already in the hands of a receiver at the place of its domicile, the court in which the application is made can do one of the three things; first, it can refuse to appoint a receiver here and let the domiciliary receiver bring suit in this state to collect all the debts of the insolvent corporation within its limits; second, it can appoint the domiciliary receiver as ancillary receiver; third, it can appoint some one other than the domiciliary receiver.

In this instance the latter course was adopted. The receivership in this state is, however, but ancillary to the receivership in New Hampshire and constitutes a mere agency to collect assets here and forward them to the original receiver, unless it appears that creditors or stockholders in this state are asserting a special right in the local assets, which right should be settled by the courts here. Whether a receiver at all should be appointed in this state depends upon the volume of business and the kind of business which the foreign corporation was here transacting, and whether, if a receiver is appointed here, the appointee should be Mr. Taggart or another depends upon several considerations, the main one being whether the interest of New Jersey parties would be likely to antagonize in any respect the interest of the general shareholders and creditors.

One prayer only in the cross-bill need be referred to to justify the appointment not only of a receiver in this state, but a receiver other than the domiciliary officer. This prayer is that the New Jersey receiver be directed to pay over the proceeds of the money collected by him to the New Hampshire assignee, to be distributed by him according to the laws of New Hampshire.

Now, a part of the money to be collected is the sum of \$30,000 deposited by the association with the secretary of state for the benefit of the creditors in this state.

This condition of affairs, therefore, raised a question of importance, namely, whether this part of the assets at least should not be retained in this state to answer the purpose for which it was deposited.

The existence of this question, however it may be decided, is sufficient to show the propriety of a separate receiver in this state. \* \* \*

(After holding that the New Jersey receiver should not be required to sue in the name of, or conform to the directions of, the New Hampshire assignee, proceeds:)

The important question discussed upon the hearing is raised by another prayer and the facts upon which it is based, namely, that Mr. Gray be directed to collect all debts and pay over all proceeds to Mr. Taggart, to be distributed according to the laws of New Hampshire.

That, as a rule, the prayer states correctly the duty of the ancillary receiver is not controverted by the counsel of the New Jersey officer. It is now admitted, and has never been denied, that the general assets of the association should be distributed by the home assignee. But there is a part of the assets in this state regarding which it is doubtful whether this general rule applies. This portion consists of the mortgages deposited with the secretary of state as a condition precedent to the association obtaining a certificate of authority to do business in this state. This deposit is of securities amounting to \$30,000, and is made under the provisions of section 3 of the act of 1890. Gen. Stat., p. 3250. The language of the statute is that the securities shall be held by the secretary of state in trust for the benefit of the creditors of such corporation within this state. \* \* \*

(After holding that shareholders would be creditors within the meaning of the statute, as to any distributive share after the debts were paid proceeds:)

The deposit of the fund in this state does not, in my judgment, change in the least the proportion to which New Jersey shareholders will be entitled. All the assets here are to be taken into account as a part of the fund to be distributed; but the right to control the fund deposited in this state for the purpose of securing the payment to shareholders in this state of their proportion of the assets to be distributed, resides in this court. Whether such fund is to be turned over to the domiciliary receiver or is to be retained here, or whether a part is to be so turned over and the remainder retained, will depend upon circumstances. All this court can reasonably exact is that its citizens shall not be driven into the court of another state to obtain their distributive shares and that the payment of such shares shall be secured, so far as the amount received from the securities deposited will furnish security. \* \* \*

The New Jersey officer will at once proceed to collect the amount of those securities. When they are all, or substantially all, collected, the New Hampshire assignee may file a petition, showing the amount of assets, as nearly as possible, the amount and character of his bond, and then this court will make an order, either that the assets in this state be paid over to Mr. Taggart, upon his giving bond in this state to pay to the New Jersey shareholders their distributive shares, or possibly upon the security of his original bond, taken together with the assumption that the court of New Hampshire will see that the shareholders everywhere are paid; or the order may be that sufficient assets may be retained here to be distributed through the hands of the receiver in this state, but according to the proportion fixed by the decree of the court of New Hampshire. The receipts of any collections by Mr. Gray, other than those thus deposited, will, after deducting expenses, be paid over at once.

*Note.* Receivers in state courts may be appointed for foreign corporations doing business there, and having property there; but if the corporation has no property, or no place of business, or no officers within the state, then a receiver can not be appointed: 1893, *Gilman v. Hudson R. B. & S. Mfg. Co.*, 84 Wis. 60, 23 L. R. A. 52, note; 1894, *Holbrook v. Ford*, 153 Ill. 633, 46 Am. St. Rep. 917; 1899, *Stockley v. Thomas*, 89 Md. 663, 43 Atl. Rep. 766.

SUB. V. THE NATIONAL GOVERNMENT AND STATE CORPORATIONS.

Sec. 499. I. Under the taxing power.

VEAZIE BANK v. FENNO.<sup>1</sup>

1869. IN THE SUPREME COURT OF THE UNITED STATES. 8 Wall.  
(75 U. S.) Rep. 533-556.

[On certificate of division for the circuit court for Maine. The bank was chartered by the state of Maine with authority to issue bank notes for circulation; it was in no way the financial agent of the state. In 1866 (14 Stat. at L. 146) congress enacted "that every national banking association, state bank, or state banking association, shall pay a tax of ten per centum on the amount of notes of any person, *state bank*, or *state banking association*, used for circulation" after August 1, 1866. The bank refused to pay the tax imposed upon notes so issued by it, upon the ground that the tax was unconstitutional as being a direct tax not apportioned as required by the constitution, and also because it impaired a franchise granted by the state.]

THE CHIEF JUSTICE (CHASE). \* \* \* (After holding the tax was not a direct tax.) Is it, then, a tax on a franchise granted by a state, which congress, upon any principle exempting the reserved powers of the states from impairment by taxation, must be held to have no authority to lay and collect?

We do not say that there may not be such a tax. It may be admitted that the reserved rights of the states, such as the right to pass laws, to give effect to laws through executive action, to administer justice through the courts, and to employ all necessary agencies for legitimate purposes of state government, are not proper subjects of the taxing power of congress. But it can not be admitted that franchises granted by a state are necessarily exempt from taxation; for franchises are property, often very valuable and productive property; and when not conferred for the purpose of giving effect to some reserved power of a state, seem to be as properly objects of taxation as any other property.

But in the case before us the object of taxation is not the franchise of the bank, but property created, or contracts made and issued under the franchise, or power to issue bank bills. A railroad company, in the exercise of its corporate franchises, issues freight receipts, bills of lading and passenger tickets; and it can not be doubted that the organization of railroads is quite as important to the state as the organization of banks. But it will hardly be questioned that these contracts of the company are objects of taxation within the powers of

<sup>1</sup>Only the part of the opinion relating to the single point given. Dissenting opinion of Nelson, J. (Davis, J., concurring) omitted, except a single paragraph.

congress, and not exempted by any relation to the state which granted the charter of the railroad. And it seems difficult to distinguish the taxation of notes issued for circulation from the taxation of these railroad contracts. Both descriptions of contracts are means of profit to the corporations which issue them; and both, as we think, may properly be made contributory to the public revenue.

It is insisted, however, that the tax in the case before us is excessive, and so excessive as to indicate a purpose on the part of congress to destroy the franchise of the bank, and is, therefore, beyond the constitutional power of congress.

The first answer to this is that the judicial can not prescribe to the legislative departments of the government limitations upon the exercise of its acknowledged powers. The power to tax may be exercised oppressively upon persons, but the responsibility of the legislature is not to the courts, but to the people by whom its members are elected. So if a particular tax bears heavily upon a corporation, or a class of corporations, it can not, for that reason only, be pronounced contrary to the constitution.

But there is another answer which vindicates equally the wisdom and the power of congress.

It can not be doubted that under the constitution the power to provide a circulation of coin is given to congress. And it is settled by the uniform practice of the government and by repeated decisions, that congress may constitutionally authorize the emission of bills of credit. It is not important here to decide whether the quality of legal tender, in payment of debts, can be constitutionally imparted to these bills; it is enough to say, that there can be no question of the power of the government to emit them; to make them receivable in payment of debts to itself; to fit them for use by those who see fit to use them in all the transactions of commerce; to provide for their redemption; to make them a currency, uniform in value and description, and convenient and useful for circulation. These powers, until recently, were only partially and occasionally exercised. Lately, however, they have been called into full activity, and congress has undertaken to supply a currency for the entire country.

The methods adopted for the supply of this currency were briefly explained in the first part of this opinion. It now consists of coin, of United States notes, and of the notes of the national banks. Both descriptions of notes may be properly described as bills of credit, for both are furnished by the government; both are issued upon the credit of the government; and the government is responsible for the redemption of both; primarily, as to the first description, and immediately upon default of the bank, as to the second. When these bills shall be made convertible into coin, at the will of the holder, this currency will, perhaps, satisfy the wants of the community, in respect to a circulating medium, as perfectly as any mixed currency that can be devised.

Having thus, in the exercise of undisputed constitutional powers, undertaken to provide a currency for the whole country, it can not be

questioned that congress may, constitutionally, secure the benefit of it to the people by appropriate legislation. To this end, congress has denied the quality of legal tender to foreign coins, and has provided by law against the imposition of counterfeit and base coin on the community. To the same end, congress may restrain, by suitable enactments, the circulation as money of any notes not issued under its own authority. Without this power, indeed, its attempts to secure a sound and uniform currency for the country must be futile.

Viewed in this light, as well as in the other light of a duty on contracts or property, we can not doubt the constitutionality of the tax under consideration.

MR. JUSTICE NELSON (dissenting). \* \* \* It is true that the present decision strikes only at the power to create banks, but no person can fail to see that the principle involved affects the power to create any other description of corporations, such as railroads, turnpikes, manufacturing companies, and others.

*Note.* See, also, 1879, *National Bank v. United States*, 101 U. S. 1; 1895, *Pollock v. Farmers' L. & T. Co.*, 157 U. S. 429, 158 U. S. 601; 1899, *Nicol v. Ames*, 173 U. S. 509.

See next case.

## Sec. 500. 2. Reorganization of state corporation as a national corporation.

### CASEY v. GALLI.<sup>1</sup>

1876. IN THE SUPREME COURT OF THE UNITED STATES. 94 U. S. Rep. (4 Otto) 673-681.

[Action at law by the receiver of the New Orleans Banking Association against Galli, a subject of Italy, and its vice-consul at Philadelphia, to enforce the individual liability of a shareholder. Among other questions raised, one was, "whether a state bank could, by authority of congress, change its organization into that of a national banking association without any authority given by the state law in its charter or otherwise to make the change."]

MR. JUSTICE SWAYNE. \* \* \* No authority from the state was necessary to enable the bank so to change its organization. The option to do that was given by the forty-fourth section of the banking act of congress. 13 Stat. 112. The power there conferred was ample, and its validity can not be doubted. The act is silent as to any assent or permission by the state. It was as competent for congress to authorize the transmutation as to create such institutions originally.

<sup>1</sup>Statement abridged. Only the part of the opinion relating to the single point is given.

*Note.* See preceding case.



Sec. 501. 3. Interstate commerce,—regulation according to state laws.

IN RE RAHRER, PETITIONER.<sup>1</sup>

1891. IN THE SUPREME COURT OF THE UNITED STATES. 140 U. S. Rep. 545-565.

[Application for writ of *habeas corpus* to U. S. circuit of Kansas, by Rahrer, who claimed to be unlawfully restrained of his liberty by the sheriff of Shawnee county, Kansas. Rahrer, as the agent of wholesale liquor dealers in Kansas City, Missouri, sold in Topeka, Kansas, in the original packages, shipped to him by the dealers in Kansas City, certain kegs of beer and bottles of whisky, contrary to the constitution and laws of Kansas, making it a misdemeanor to make such sales without a license, and contrary to the "Wilson act" of congress (1890, 26 St. 313, ch. 728) providing that all such liquors "transported into any state or territory, or remaining therein for use, consumption, sale, or storage therein, shall upon arrival in such state, etc., be subject to the operation and effect of the laws of such state, etc., to the same extent and in the same manner as though produced in such state," etc. The circuit court discharged the petitioner and an appeal was taken.]

MR. CHIEF JUSTICE FULLER. The power of the state to impose restraints and burdens upon persons and property in conservation and promotion of public health, good order and prosperity, is a power originally and always belonging to the states, not surrendered by them to the general government nor directly restrained by the constitution of the United States, and essentially exclusive.

And this court has uniformly recognized state legislation, legitimately for police purposes, as not in the sense of the constitution necessarily infringing upon any right which has been confided expressly or by implication to the national government.

The fourteenth amendment, in forbidding a state to make or enforce any law abridging the privileges or immunities of citizens of the United States, or to deprive any person of life, liberty or property without due process of law, or to deny to any person within its jurisdiction the equal protection of the laws, did not invest, and did not attempt to invest, congress with power to legislate upon subjects which are within the domain of state legislation.

As observed by Mr. Justice Bradley, delivering the opinion of the court in the Civil Rights cases, 109 U. S. 3, 13, the legislation under that amendment can not "properly cover the whole domain of rights appertaining to life, liberty and property, defining them and providing for their vindication. That would be to establish a code of municipal law regulative of all private rights between man and man in society. It would be to make congress take the place of the state legislatures and to supersede them. It is absurd to affirm that, because

<sup>1</sup> Statement abridged, arguments and part of opinion omitted.

the rights of life, liberty and property (which include all civil rights that men have) are by the amendment sought to be protected against invasion on the part of the state without due process of law, congress may therefore provide due process of law for their vindication in every case; and that, because the denial by a state to any persons, of the equal protection of the laws, is prohibited by the amendment, therefore congress may establish laws for their equal protection."

In short, it is not to be doubted that the power to make the ordinary regulations of police remains with the individual states, and can not be assumed by the national government, and that in this respect it is not interfered with by the fourteenth amendment. *Barbier v. Connolly*, 113 U. S. 27, 31.

The power of congress to regulate commerce among the several states, when the subjects of that power are national in their nature, is also exclusive. The constitution does not provide that interstate commerce shall be free, but, by the grant of this exclusive power to regulate it, it was left free except as congress might impose restraint. Therefore, it has been determined that the failure of congress to exercise this exclusive power in any case is an expression of its will that the subject shall be free from restrictions or impositions upon it by the several states. *Robbins v. Shelby Taxing District*, 120 U. S. 489. And if a law passed by a state in the exercise of its acknowledged powers comes into conflict with that will, the congress and the state can not occupy the position of equal opposing sovereignties, because the constitution declares its supremacy and that of the laws passed in pursuance thereof. *Gibbons v. Ogden*, 9 Wheat. 1, 210. That which is not supreme must yield to that which is supreme. *Brown v. Maryland*, 12 Wheat. 419, 448.

"Commerce, undoubtedly, is traffic," said Chief Justice Marshall, "but it is something more; it is intercourse. It describes the commercial intercourse between nations and parts of nations in all its branches, and is regulated by prescribing rules for carrying on that intercourse." Unquestionably, fermented, distilled or other intoxicating liquors or liquids are subjects of commercial intercourse, exchange, barter and traffic, between nation and nation, between state and state, like any other commodity in which a right of traffic exists, and are so recognized by the usages of the commercial world, the laws of congress and the decisions of courts. Nevertheless, it has been often held that state legislation which prohibits the manufacture of spirituous, malt, vinous, fermented or other intoxicating liquors within the limits of a state, to be there sold or bartered for general use as a beverage, does not necessarily infringe any right, privilege or immunity secured by the constitution of the United States or by the amendments thereto. *Mugler v. Kansas*, 123 U. S. 623, and cases cited. "These cases," in the language of the opinion in *Mugler v. Kansas* (page 569), "rest upon the acknowledged right of the states of the Union to control their purely internal affairs, and, in so doing, to protect the health, morals, and safety of their people by regulations that do not interfere with the execution of the powers of the general government, or

violate rights secured by the constitution of the United States. The power to establish such regulations, as was said in *Gibbons v. Ogden*, 9 Wheat. 1, 203, reaches everything within the territory of a state not surrendered to the national government." But it was not thought in that case that the record presented any question of the invalidity of state laws because repugnant to the power to regulate commerce among the states. It is upon the theory of such repugnancy that the case before us arises and involves the distinction which exists between the commercial power and the police power, which, "though quite distinguishable when they do not approach each other, may yet, like the intervening colors between white and black, approach so nearly as to perplex the understanding, as colors perplex the vision in marking the distinction between them." 12 Wheat. 441. \* \* \*

Congress has now spoken, and declared that imported liquors or liquids shall, upon arrival in a state, fall within the category of domestic articles of a similar nature. Is the law open to constitutional objection?

By the first clause of section 10 of article '1 of the constitution, certain powers are enumerated which the states are forbidden to exercise in any event; and by clauses two and three, certain others, which may be exercised with the consent of congress. As to those in the first class, congress can not relieve from the positive restriction imposed. As to those in the second, their exercise may be authorized; and they include the collection of the revenue from imposts and duties on imports and exports, by state enactments, subject to the revision and control of congress; and a tonnage duty, to the exaction of which only the consent of congress is required. Beyond this, congress is not empowered to enable the state to go in this direction. Nor can congress transfer legislative powers to a state nor sanction a state law in violation of the constitution; and if it can adopt a state law as its own, it must be one that it would be competent for it to enact itself, and not a law passed in the exercise of the police power. *Cooley v. Port Wardens of Philadelphia*, 12 How. 299; *Gunn v. Barry*, 15 Wall. 610, 623; *United States v. Dewitt*, 9 Wall. 41.

It does not admit of argument that congress can neither delegate its own powers nor enlarge those of a state. This being so, it is urged that the act of congress can not be sustained as a regulation of commerce, because the constitution, in the matter of interstate commerce, operates *ex proprio vigore* as a restraint upon the power of congress to so regulate it as to bring any of its subjects within the grasp of the police power of the state. \* \* \*

We do not concur in this view. In surrendering their own power over external commerce the states did not secure absolute freedom in such commerce, but only the protection from encroachment afforded by confiding its regulation exclusively to congress.

By the adoption of the constitution the ability of the several states to act upon the matter solely in accordance with their own will was extinguished, and the legislative will of the general government sub-

stituted. No affirmative guaranty was thereby given to any state of the right to demand, as between it and the others, what it could not have obtained before; while the object was undoubtedly sought to be attained of preventing commercial regulations partial in their character or contrary to the common interests. And the magnificent growth and prosperity of the country attest the success which has attended the accomplishment of that object. But this furnishes no support to the position that congress could not, in the exercise of the discretion reposed in it, concluding that the common interests did not require entire freedom in the traffic in ardent spirits, enact the law in question. In so doing congress has not attempted to delegate the power to regulate commerce, or to exercise any power reserved to the states, or to grant a power not possessed by the states, or to adopt state laws. It has taken its own course and made its own regulation, applying to these subjects of interstate commerce one common rule, whose uniformity is not affected by variations in state laws in dealing with such property. \* \* \*

The power to regulate is solely in the general government, and it is an essential part of that regulation to prescribe the regular means for accomplishing the introduction and incorporation of articles into and with the mass of property in the country or state. 12 Wheat. 448.

No reason is perceived why, if congress chooses to provide that certain designated subjects of interstate commerce shall be governed by a rule which divests them of that character at an earlier period of time than would otherwise be the case, it is not within its competency to do so. \* \* \*

This is not the case of a law enacted in the unauthorized exercise of a power exclusively confided to congress, but of a law which it was competent for the state to pass, but which could not operate upon articles occupying a certain situation until the passage of the act of congress. That act in terms removed the obstacle, and we perceive no adequate ground for adjudging that a re-enactment of the state law was required before it could have the effect upon imported which it had always had upon domestic property.

Jurisdiction attached, not in virtue of the law of congress, but because the effect of the latter was to place the property where jurisdiction could attach.

*The decree is reversed, and the cause remanded for further proceedings in conformity with this opinion.*

Mr. Justice Harlan, Mr. Justice Gray and Mr. Justice Brewer concurred in the judgment of reversal, but not in all the reasoning of the opinion of the court.

*Note.* It seems that congress may either grant to the states in some particulars regulative power over interstate commerce, or may make effective legislation of the states that would otherwise be ineffective as regulations of interstate commerce, and in this way give the states power to exclude such foreign corporations engaged in such commerce, as the state has as to corporations not engaged in such commerce: 1855, *Pennsylvania v. Wheeling Bridge Co.*, 18 How. 421; 1877, *Hall v. De Cuir*, 95 U. S. 485; 1890, *Leisy v. Hardin*, 135 U. S. 100; 1896, *Scott v. Donald*, 165 U. S. 58; 1897, *Rhodes v. Iowa*, 170 U. S. 412; 1898, *People v. Hawkins*, 157 N. Y. 1; 1898, *Vance v. Vandercook*, 170 U. S. 438.

Sec. 502. 4. Interstate commerce commission.

MR. JUSTICE BREWER IN INTERSTATE COMMERCE COMMISSION  
v. CINCINNATI, N. O. & T. P. CO.

1897. IN THE SUPREME COURT OF THE UNITED STATES. 167  
U. S. Rep. 479-511, on 505-507.

[As to the powers of the interstate commerce commission.]

We have, therefore, these considerations presented: First, the power to prescribe a tariff of rates for carriage by common carrier is a legislative and not an administrative or judicial function, and, having respect to the large amount of property invested in railroads, the various companies engaged therein, the thousands of miles of road, and the millions of tons of freight carried, the varying and diverse conditions attaching to such carriage is a power of supreme delicacy and importance. Second, that congress has transferred such a power to any administrative body is not to be presumed or implied from any doubtful and uncertain language. The words and phrases efficacious to make such a delegation of power are well understood and have been frequently used, and if congress had intended to grant such a power to the interstate commerce commission it can not be doubted that it would have used language open to no misconstruction, but clear and direct. Third, incorporating into a statute the common law obligation resting upon the carrier to make all its charges reasonable and just, and directing the commission to execute and enforce the provisions of the act, does not by implication carry to the commission or invest it with the power to exercise the legislative function of prescribing rates which shall control in the future. Fourth, beyond the inference which irresistibly follows from the omission to grant in express terms to the commission this power of fixing rates, is the clear language of section 6, recognizing the right of the carrier to establish rates, to increase or reduce them, and prescribing the conditions upon which such increase or reduction may be made, and requiring, as the only conditions of its action, first, publication, and second, the filing of the tariff with the commission. The grant to the commission of the power to prescribe the form of the schedules, and to direct the place and manner of publication of joint rates, thus specifying the scope and limit of its functions in this respect, strengthens the conclusion that the power to prescribe rates or fix any tariff for the future is not among the powers granted to the commission.

These considerations convince us that under the interstate commerce act the commission has no power to prescribe the tariff of rates which shall control in the future, and, therefore, can not invoke a judgment in mandamus from the courts to enforce any such tariff by it prescribed.

But has the commission no functions to perform in respect to the matter of rates; no power to make any inquiry in respect thereto? Unquestionably it has, and most important duties in respect to this

matter. It is charged with the general duty of inquiring as to the management of the business of railroad companies, and to keep itself informed as to the manner in which the same is conducted, and has the right to compel complete and full information as to the manner in which such carriers are transacting their business. And with this knowledge it is charged with the duty of seeing that there is no violation of the long- and short-haul clause; that there is no discrimination between individual shippers, and that nothing is done by rebate or any other device to give preference to one as against another; that no undue preferences are given to one place or places or individual or class of individuals, but that in all things that equality of right, which is the great purpose of the interstate commerce act, shall be secured to all shippers. It must also see that that publicity, which is required by section 6, is observed by the railroad companies. Holding the railroad companies to strict compliance with all these statutory provisions and enforcing obedience to all these provisions tends, as observed by Commissioner Cooley in *In re Chicago, St. Paul & Kansas City Railway*, 2 Int. Com. Com. Rep. 231, 261, to both reasonableness and equality of rate, as contemplated by the interstate commerce act.

*Note.* See, 1886, *Wabash, St. L. & P. R. v. Illinois*, 118 U. S. 557; 1892, *Interstate Com. Com. v. B. & O. R.*, 145 U. S. 263; 1894, *Interstate Com. Com. v. Brimson*, 154 U. S. 447; 1896, *Brown v. Walker*, 161 U. S. 591; 1897, *Interstate Com. Com. v. Ala. M. R.*, 168 U. S. 144.

### Sec. 503. 5. Interstate commerce—Anti-trust acts.

#### ADDYSTON PIPE AND STEEL COMPANY v. UNITED STATES.<sup>1</sup>

1899. IN THE SUPREME COURT OF THE UNITED STATES. 175 U. S. Rep. 211-248.

[Appeal from decision of circuit court of appeals. For statement of facts, see *supra*, p. 967.]

MR. JUSTICE PECKHAM. \* \* \* Assuming, for the purpose of the argument, that the contract in question herein does directly and substantially operate as a restraint upon and as a regulation of interstate commerce, it is yet insisted by the appellants at the threshold of the inquiry that by the true construction of the constitution, the power of congress to regulate interstate commerce is limited to its protection from acts of interference by state legislation or by means of regulations made under the authority of the state by some political subdivision thereof, including also congressional power over common carriers, elevator, gas and water companies, for reasons stated to be peculiar to such carriers and companies, but that it does not include

<sup>1</sup> Arguments and part of opinion omitted.



the general power to interfere with or prohibit private contracts between citizens, even though such contracts have interstate commerce for their object, and result in a direct and substantial obstruction to or regulation of that commerce.

This argument is founded upon the assertion that the reason for vesting in congress the power to regulate commerce was to insure uniformity of regulation against conflicting and discriminating state legislation; and the further assertion that the constitution guarantees liberty of private contract to the citizens at least upon commercial subjects, and to that extent the guaranty operates as a limitation on the power of congress to regulate commerce. \* \* \*

(Quoting from the *State Freight Tax*, 15 Wall. 232, 275; *Railroad Co. v. Richmond*, 19 Wall. 584, 589.) It is undoubtedly true that among the reasons, if not the strongest reason, for placing the power in congress to regulate interstate commerce, was that which is stated in the extracts from the opinions of the court in the cases above cited.

The reasons which may have caused the framers of the constitution to repose the power to regulate interstate commerce in congress do not, however, affect or limit the extent of the power itself.

In *Gibbons v. Ogden*, 9 Wheat. 1, the power was declared to be complete in itself, and to acknowledge no limitations other than are prescribed by the constitution.

Under this grant of power to congress, that body, in our judgment, may enact such legislation as shall declare void and prohibit the performance of any contract between individuals or corporations where the natural and direct effect of such a contract will be, when carried out, to directly, and not as a mere incident to other and innocent purposes, regulate to any substantial extent interstate commerce. (And when we speak of interstate we also include in our meaning foreign commerce.) We do not assent to the correctness of the proposition that the constitutional guaranty of liberty to the individual to enter into private contracts limits the power of congress and prevents it from legislating upon the subject of contracts of the class mentioned.

The power to regulate interstate commerce is, as stated by Chief Justice Marshall, full and complete in congress, and there is no limitation in the grant of the power which excludes private contracts of the nature in question from the jurisdiction of that body. Nor is any such limitation contained in that other clause of the constitution which provides that no person shall be deprived of life, liberty or property without due process of law. It has been held that the word "liberty," as used in the constitution, was not to be confined to the mere liberty of person, but included, among others, a right to enter into certain classes of contracts for the purpose of enabling the citizen to carry on his business. *Allgeyer v. Louisiana*, 165 U. S. 578; *United States v. Joint Traffic Association*, 171 U. S. 505, 572. But it has never been, and in our opinion ought not to be, held that the word included the right of an individual to enter into private contracts upon all subjects, no matter what their nature and wholly irrespective (among other things) of the fact that they would, if performed, result in the regulation of interstate commerce and in the

violation of an act of congress upon that subject. The provision in the constitution does not, as we believe, exclude congress from legislating with regard to contracts of the above nature while in the exercise of its constitutional right to regulate commerce among the states. On the contrary, we think the provision regarding the liberty of the citizen is, to some extent, limited by the commerce clause of the constitution, and that the power of congress to regulate interstate commerce comprises the right to enact a law prohibiting the citizen from entering into those private contracts which directly and substantially, and not merely indirectly, remotely, incidentally and collaterally, regulate to a greater or less degree commerce among the states. \* \* \*

In the Debs case, 158 U. S. 564, it was said by Mr. Justice Brewer, speaking for the court: "It is curious to note the fact that in a large proportion of the cases in respect to interstate commerce brought to this court the question presented was of the validity of state legislation in its bearing upon interstate commerce, and the uniform course of decision has been to declare that it is not within the competency of a state to legislate in such a manner as to obstruct interstate commerce. If a state, with its recognized power of sovereignty, is impotent to obstruct interstate commerce, can it be that any mere voluntary association of individuals within the limits of that state has a power which the state itself does not possess?"

What sound reason can be given why congress should have the power to interfere in the case of the state, and yet have none in the case of the individual? Commerce is the important subject of consideration, and anything which directly obstructs and thus regulates that commerce which is carried on among the states, whether it is state legislation or private contracts between individuals or corporations, should be subject to the power of congress in the regulation of that commerce. \* \* \*

It is, indeed, urged that to include private contracts of this description within the grant of this power to congress is to take from the states their own power over the subject, and to interfere with the liberty of the individual in a manner and to an extent never contemplated by the framers of the constitution, and not fairly justified by any language used in that instrument. If congress has not the power to legislate upon the subject of contracts of the kind mentioned, because the constitutional provision as to the liberty of the citizen limits, to that extent, its power to regulate interstate commerce, then it would seem to follow that the several states have that power although such contracts relate to interstate commerce, and, more or less, regulate it. If neither congress nor the state legislatures have such power, then we are brought to the somewhat extraordinary position that there is no authority, state or national, which can legislate upon the subject of or prohibit such contracts. This can not be the case. \* \* \*

We conclude that the plain language of the grant to congress of power to regulate commerce among the several states includes power to legislate upon the subject of those contracts in respect to interstate or foreign commerce which directly affect and regulate that commerce,

and we can find no reasonable ground for asserting that the constitutional provision as to the liberty of the individual limits the extent of that power as claimed by the appellants. We therefore think the appellants have failed in their contention upon this branch of the subject.

We are thus brought to the question whether the contract or combination proved in this case is one which is either a direct restraint or a regulation of commerce among the several states or with foreign nations contrary to the act of congress. It is objected on the part of the appellants that even if it affected interstate commerce the contract or combination was only a reasonable restraint upon a ruinous competition among themselves, and was formed only for the purpose of protecting the parties thereto in securing prices for their product that were fair and reasonable to themselves and the public. It is further objected that the agreement does not come within the act because it is not one which amounts to a regulation of interstate commerce, as it has no direct bearing upon or relation to that commerce, but that on the contrary the case herein involves the same principles which were under consideration in *United States v. E. C. Knight Company*, 156 U. S. 1, and, in accordance with that decision, the bill should be dismissed.

Referring to the first of these objections to the maintenance of this proceeding, we are of opinion that the agreement or combination was not one which simply secured for its members fair and reasonable prices for the article dealt in by them.

(After recounting the facts.)

The facts<sup>1</sup> thus set forth show conclusively that the effect of the combination was to enhance prices beyond a sum which was reasonable, and therefore the first objection above set forth need not be further noticed.

We are also of opinion that the direct effect of the agreement or combination is to regulate interstate commerce, and the case is therefore not covered by that of *United States v. E. C. Knight Company*, *supra*. It was there held that although the American Sugar Refining Company, by means of the combination referred to, had obtained a practical monopoly of the business of manufacturing sugar, yet the act of congress did not touch the case, because the combination only related to manufacture and not to commerce among the states or with foreign nations. The plain distinction between manufacture and commerce was pointed out, and it was observed that a contract or combination which directly related to manufacture only was not brought within the purview of the act, although as an indirect and incidental result of such combination commerce among the states might be thereafter somewhat affected. \* \* \*

The direct purpose of the combination in the Knight case was the control of the manufacture of sugar. There was no combination or agreement, in terms, regarding the future disposition of the manufactured article; nothing looking to a transaction in the nature of interstate commerce. The probable intention on the part of the manufacturer of the sugar to thereafter dispose of it by sending it to some

<sup>1</sup> See *supra*, p. 967.

market in another state, was held to be immaterial and not to alter the character of the combination. The various cases which had been decided in this court relating to the subject of interstate commerce, and to the difference between that and the manufacture of commodities, and also the police power of the states as affected by the commerce clause of the constitution, were adverted to, and the case was decided upon the principle that a combination simply to control manufacture was not a violation of the act of congress, because such a contract or combination did not directly control or affect interstate commerce, but that contracts for the sale and transportation to other states of specific articles were proper subjects for regulation because they did form part of such commerce.

We think the case now before us involves contracts of the nature last above mentioned, not incidentally or collaterally, but as a direct and immediate result of the combination engaged in by the defendants.

While no particular contract regarding the furnishing of pipe and the price for which it should be furnished was in the contemplation of the parties to the combination at the time of its formation, yet it was their intention, as it was the purpose of the combination, to directly and by means of such combination increase the price for which all contracts for the delivery of pipe within the territory above described should be made, and the latter result was to be achieved by abolishing all competition between the parties to the combination. The direct and immediate result of the combination was therefore necessarily a restraint upon interstate commerce in respect of articles manufactured by any of the parties to it to be transported beyond the state in which they were made. The defendants by reason of this combination and agreement could only send their goods out of the state in which they were manufactured for sale and delivery in another state, upon the terms and pursuant to the provisions of such combination. As pertinently asked by the court below, was not this a direct restraint upon interstate commerce in those goods? \* \* \*

As has frequently been said, interstate commerce consists of intercourse and traffic between the citizens or inhabitants of different states, and includes not only the transportation of persons and property and the navigation of public waters for that purpose, but also the purchase, sale and exchange of commodities. *Gloucester Ferry Co. v. Pennsylvania*, 114 U. S. 196-203; *Kidd v. Pearson*, 128 U. S. 1, 20. If, therefore, an agreement or combination directly restrains not alone the manufacture, but the purchase, sale or exchange of the manufactured commodity among the several states, it is brought within the provisions of the statute. The power to regulate such commerce, that is, the power to prescribe the rules by which it shall be governed, is vested in congress, and when congress has enacted a statute such as the one in question, any agreement or combination which directly operates, not alone upon the manufacture, but upon the sale, transportation and delivery of an article of interstate commerce, by preventing or restricting its sale, etc., thereby regulates interstate com-

merce to that extent, and to the same extent trenches upon the power of the national legislature and violates the statute. We think it plain that this contract or combination affects that result. \* \* \*

In regard to such of these defendants as might reside and carry on business in the same state where the pipe provided for in any particular contract was to be delivered, the sale, transportation and delivery of the pipe by them under that contract would be a transaction wholly within the state, and the statute would not be applicable to them in that case. They might make any combination they chose with reference to the proposed contract, although it should happen that some non-resident of the state eventually obtained it.

The fact that the proposal called for the delivery of pipe in the same state where some of the defendants resided and carried on their business would be sufficient, so far as the act of congress is concerned, to permit those defendants to combine as they might choose, in regard to the proposed contract for the delivery of the pipe, and that right would not be affected by the fact, that the contract might be subsequently awarded to some one outside the state as the lowest bidder. In brief, their right to combine in regard to a proposal for pipe deliverable in their own state could not be reached by the federal power derived from the commerce clause in the constitution.

To the extent that the present decree includes in its scope the enjoining of defendants thus situated from combining in regard to contracts for selling pipe in their own state, it is modified, and limited to that portion of the combination or agreement which is interstate in its character. As thus modified, the decree is

*Affirmed.*

*Note.* See report of this case in circuit court of appeals, *supra*, p. 967. 1891, U. S. v. Jellico Mountain, etc., Co., 46 Fed. Rep. 432; 1892, Bishop v. American Preservers Co., 51 Fed. Rep. 272; 1892, U. S. v. Greenhut, 51 Fed. Rep. 205, 213; 1892, U. S. v. Nelson, 52 Fed. Rep. 646; 1893, Blindell v. Hagan, 54 Fed. Rep. 40; 1893, U. S. v. Patterson, 55 Fed. Rep. 605; 1893, U. S. v. Workingmen's Amal. Council, 54 Fed. Rep. 994; 1893, Waterhouse v. Comer, 55 Fed. Rep. 149; 1893, Dueber Watch Case Mfg. Co. v. Howard, etc., Co., 55 Fed. Rep. 851; 1894, U. S. v. Debs, 64 Fed. Rep. 724; 1895, U. S. v. E. C. Knight Co., 156 U. S. 1; 1895, American Soda Fountain Co. v. Green, 69 Fed. Rep. 333; 1897, In re Grice, 79 Fed. Rep. 627; 1897, U. S. v. Trans-Mo. Frt. Assn., 166 U. S. 290; 1898, U. S. v. Coal Dealers' Assn., 85 Fed. Rep. 252; 1898, U. S. v. Joint Traffic Assn., 171 U. S. 505; 1898, Hopkins v. U. S., 171 U. S. 578; 1898, Anderson v. U. S., 171 U. S. 604; 1898, Indiana Express Co. v. U. S. Express Co., 88 Fed. Rep. 659; 1899, Lowry v. Tile, Mantel, etc., Assn., 98 Fed. Rep. 817; 1900, Dickerman v. Northern Trust Co., 176 U. S. 181; 1900, City of Atlanta v. Chattanooga Foundry, etc., 101 Fed. Rep. 900; 1900, Gibbs v. McNeeley, 102 Fed. Rep. 594; 1900, U. S. v. Chesapeake & O. Fuel Co., 105 Fed. Rep. 93; 1904, Montague v. Lowry, 193 U. S. 38; 1904, Northern Securities Co. v. United States, 193 U. S. 197-411.



Sec. 504. 6. Control of the mails.

IN RE RAPIER, PETITIONER.<sup>1</sup>

1892. IN THE SUPREME COURT OF THE UNITED STATES. 143 U.  
S. Rep. 110-135.

[Application for leave to file petitions for writ of *habeas corpus* to be delivered from arrest for violating the anti-lottery act (1890, 26 St. 465, ch. 908), providing that "no letter, postal card or circular concerning any lottery, \* \* \* no list of drawings, \* \* \* and no lottery ticket shall be carried in the mail, etc., \* \* \* and any person who shall knowingly deposit anything to be conveyed \* \* \* in violation of this" act shall, upon conviction, be fined or imprisoned, etc.]

MR. CHIEF JUSTICE FULLER. \* \* \* These are applications for discharge by writ of *habeas corpus* from arrest for alleged violations of an act of congress, approved September 19, 1890, entitled "An act to amend certain sections of the revised statutes relating to lotteries, and for other purposes." 26 Stat. 465, ch. 908.

The question for determination relates to the constitutionality of section 3894 of the Revised Statutes as amended by that act. In *Ex parte Jackson*, 96 U. S. 727, it was held that the power vested in congress to establish post-offices and post-roads embraced the regulation of the entire postal system of the country, and that under it congress may designate what may be carried in the mail and what excluded; that in excluding various articles from the mails the object of congress is not to interfere with the freedom of the press or with any other rights of the people, but to refuse the facilities for the distribution of matter deemed injurious by congress to the public morals; and that the transportation in any other way of matters excluded from the mails would not be forbidden. Unless we are prepared to overrule that decision, it is decisive of the question before us. \* \* \*

The states before the Union was formed could establish post-offices and post-roads, and in doing so could bring into play the police power in the protection of their citizens from the use of the means so provided for purposes supposed to exert a demoralizing influence upon the people. When the power to establish post-offices and post-roads was surrendered to the congress it was as a complete power, and the grant carried with it the right to exercise all the powers which made that power effective. It is not necessary that congress should have the power to deal with crime or immorality within the states in order to maintain that it possesses the power to forbid the use of the mails in aid of the perpetration of crime or immorality. \* \* \*

We can not regard the right to operate a lottery as a fundamental right infringed by the legislation in question; nor are we able to see that congress can be held, in its enactment, to have abridged the freedom of the press. The circulation of newspapers is not pro-

<sup>1</sup> Statement abridged. Elaborate arguments and part of opinion omitted.



hibited, but the government declines itself to become an agent in the circulation of printed matter which it regards as injurious to the people. The freedom of communication is not abridged within the intent and meaning of the constitutional provision unless congress is absolutely destitute of any discretion as to what shall or shall not be carried in the mails, and compelled arbitrarily to assist in the dissemination of matters condemned by its judgment, through the governmental agencies which it controls. That power may be abused furnishes no ground for a denial of its existence, if government is to be maintained at all.

In short, we do not find sufficient grounds in the arguments of counsel, able and exhaustive as they have been, to induce us to change the views already expressed in the case to which we have referred. We adhere to the conclusion therein announced.

*The writs of habeas corpus prayed for will therefore be denied, and the rules hereinbefore entered discharged.*

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Sec. 505. 7. Receivers in the United States courts.

SHINNEY v. NORTH AMERICAN SAVINGS, LOAN AND BUILDING COMPANY ET AL.

1899. IN THE UNITED STATES CIRCUIT COURT, DISTRICT OF UTAH.  
97 Fed. Rep. 9-12.

MARSHALL, District Judge. The plaintiff brought this suit in a state court against the North American Savings, Loan and Building Company, a corporation, Edward B. Graves, its receiver, heretofore appointed by this court, and the Norwich Union Fire Insurance Company. The object of this suit is to have an account taken of the sum due by plaintiff on a note and mortgage made to the first defendant, and to recover from the insurance company the amount of a policy of insurance on a house, a part of the mortgaged property, and heretofore destroyed by fire, less, however, the sum found due the first-named defendant and its receiver on such accounting. The insurance company admits its liability on the policy, and is willing to pay the same to whomsoever may be determined as entitled thereto. The receiver removed the suit into this court. The plaintiff now moves to remand on the following grounds: (1) That the suit of A. V. McIntosh against the North American Savings, Loan and Building Company, in which suit said receiver was appointed, did not give this court jurisdiction to appoint a receiver; (2) that, even if jurisdiction to appoint a receiver existed, it could not be exercised for the purpose of an appointment ancillary to a primary administration in a state court of another state; (3) that the proceedings for the appointment of a receiver of the assets of the North American Savings, Loan and

Building Company in Utah was ancillary to the primary suit in a state court of Minnesota, and hence could not be removed to a federal court; (4) that the value of the matter in dispute in the present case does not exceed the sum of \$2,000. These objections will be considered in the order named.

1. The case of McIntosh against the North American Savings, Loan and Building Company was instituted in a state court, and a receiver of the assets of the defendant within the state of Utah was appointed by that court in advance of an appearance by the defendant. The defendant, a foreign corporation, thereafter removed it into this court. Subsequently the receiver so appointed resigned, and the defendant Edward B. Graves was permitted to file a petition in that suit, in which it was alleged that he had been appointed the receiver of the North American Savings, Loan and Building Company by a state court of Minnesota, in a suit then pending, and prior to the institution of any proceedings in Utah; that the corporation had been organized under the laws of Minnesota, and had its general offices there; that in said suit the insolvency of the corporation and the necessity for a receiver was shown; that he had duly qualified as such receiver; and he prayed that he might be appointed by this court receiver of the assets of said corporation within Utah, and that such receivership be ancillary to the primary administration of the state court of Minnesota. Thereupon said Graves was appointed as receiver by this court, and he duly qualified as such. In his motion to remand, the plaintiff, Shinney, attacks collaterally the jurisdiction of the court in the case of McIntosh against the North American Savings, Loan and Building Company. He was not a party to that suit, nor is this proceeding appropriate for the correction of any error therein. The propriety of the original appointment of a receiver, or of the appointment of defendant Graves as ancillary receiver, is not material here, if jurisdiction to make the appointment existed. That a general power exists to appoint a receiver of the assets of a foreign corporation within the jurisdiction of the court appointing is well settled. *Williams v. Hintermeister*, 26 Fed. Rep. 889; *Murray v. Vanderbilt*, 39 Barb. 140; *Trust Co. v. Miller*, 33 N. J. Eq. 155; 5 *Thomp. Corp.*, §§ 6860, 6861. And the case of *Buswell v. Order of Iron Hall*, 161 Mass. 224, 36 N. E. Rep. 1065, is a precedent for the appointment here made. Jurisdiction of the person is unquestioned. The corporation was regularly served with process, appeared, and answered the complaint, and has never objected to the jurisdiction. The appointment of a receiver was a part of the relief expressly sought in the suit, and there was an attempt to state a cause of action therefor. If, for the purposes of the argument, it were admitted that the complaint did not state a good cause of action, or affirmatively showed that the plaintiff was not entitled to the relief prayed, the jurisdiction would still exist. An appointment on such a bill would be erroneous, but in no sense void. The action of the court being properly invoked, its determination would not be void for want of jurisdiction, so long as it was within the issues tendered.

Reynolds v. Stockton, 140 U. S. 254-269, 11 Sup. Ct. 773; Moore v. Martin, 38 Cal. 428; Ricketts v. Spraker, 77 Ind. 371; In re Latta, 43 Kan. 533, 23 Pac. Rep. 655; Young v. Lorain, 11 Ill. 624; Van Fleet Col. Attack, § 61.

2. It is admitted that, when a receiver is once appointed by a federal court, other federal courts, through comity, will usually appoint the same person as receiver of the assets within their jurisdiction; but it is argued that, where the appointment is first made by a state court, federal courts are without power to act, in conformity with the principle of comity. No reason for such a distinction is apparent. The state court is of co-ordinate jurisdiction in such matters with the federal court sitting in the same locality. As between the parties, its determination of the insolvency of the corporation and of the need for a receiver is just as conclusive as if had in a federal court. The need for a uniform administration of the assets of an insolvent corporation inheres in the principles of equity, and does not vary with the forum first invoked. It is no unusual thing for a federal court to appoint an ancillary receiver of assets within its jurisdiction in aid of a primary appointment by a state court of another state. Sands v. E. S. Greeley & Co., 31 C. C. A. 424, 88 Fed. Rep. 130.

In Rust v. Water-works Co., 17 C. C. A. 16-20, 70 Fed. Rep. 129-133, the circuit court of appeals of the eighth circuit, said:

"It goes without saying that the court below (United States Circuit Court for the district of Colorado) had the power, upon the presentation to it of the decree of the court of chancery of the state of New Jersey appointing the plaintiff in error the receiver of the property of this insolvent corporation, and the trustee for its creditors and stockholders, to appoint him receiver and trustee, with the same powers, in the district of Colorado, and to authorize him to sue for and to defend suits against the water-works company in that district in the name of the corporation or in his own name."

The plaintiff's contention is without merit.

3. The third objection confounds the nature of a suit for ancillary receivership. It is in no sense a continuation of, or an incident to, the suit in which the primary receiver was appointed. A judgment against the ancillary receiver does not bind assets beyond the jurisdiction of the court appointing him. Reynolds v. Stockton, 140 U. S. 254, 11 Sup. Ct. 773; Johnson v. Powers, 139 U. S. 156, 11 Sup. Ct. 525. "Where a receiver, administrator, or other custodian of an estate is appointed by the courts of one state, the courts of that state reserve to themselves full and exclusive jurisdiction over the assets of the estate, within the limits of the state." Reynolds v. Stockton, *supra*. "It rests in the discretion of the court appointing the receiver whether the assets within its jurisdiction shall be distributed under its own direction, or shall be transmitted to the primary receiver. U. S. v. Coxe, 18 How. 105." Sands v. E. S. Greeley & Co., 31 C. C. A. 424-426, 88 Fed. 130-133. The two proceedings are entirely independent. The need for a uniform and equitable

distribution of the assets alone moves the discretion of the court of so-called "ancillary jurisdiction" to transmit them to the court of primary jurisdiction. Evidently, to insure equality among creditors, some one court must determine their rights, although the assets may be scattered through many jurisdictions. Among co-ordinate courts, the court of primary jurisdiction is selected for this purpose, not because of any paramount jurisdiction inhering in it, but because of the necessity of making some selection, and of the difficulty of formulating any principle of selection other than that of the first in time.

4. It is true that the matter in dispute in this action does not exceed in value the sum of \$2,000, and it would therefore not be removable to this court, except that in a suit pending here the defendant Graves has been appointed receiver of the assets of the North American Savings, Loan and Building Company, that he is sued as such receiver, and the object of the suit is to determine his right to assets claimed by him as receiver. For the purposes of jurisdiction, this suit must be considered as ancillary to the suit pending in this court, in which he was appointed receiver, and, as such, cognizable here, irrespective of citizenship of parties or of amount in controversy. *White v. Ewing*, 159 U. S. 36, 15 Sup. Ct. 1018; *State of Washington v. Northern Pac. R. Co.*, 75 Fed. 333; *Carpenter v. Railroad Co.*, 75 Fed. 850; *Sullivan v. Barnard*, 81 Fed. 886; *Bausman v. Denny*, 73 Fed. 69. The motion to remand is denied.

*Note:* See, 1886, *Peper v. Fordyce*, 119 U. S. 469; 1889, *In re Farmers' L. & T. Co.*, 129 U. S. 206; 1885, *Chicot Co. v. Sherwood*, 148 U. S. 529; 1893, *Empire Coal, etc., Co. v. Empire Coal & M. Co.*, 150 U. S. 159; 1893, *U. S. Trust Co. v. Wabash R. Co.*, 150 U. S. 287; 1895, *White v. Ewing*, 159 U. S. 36; 1900, *Hutchinson v. Am. Palace Car Co.*, 104 Fed. Rep. 182; 1900, *Hale v. Tyler*, 104 Fed. Rep. 757.

TITLE II. THE CORPORATION AND VARIOUS CLASSES OF PERSONS.<sup>1</sup>

## CHAPTER 17.

THE RELATION OF THE CORPORATION TO ITS PROMOTERS,  
OFFICERS, SHAREHOLDERS, CREDITORS AND OTHERS.

## SUBDIVISION I. THE CORPORATION AND ITS PROMOTERS.

## Sec. 506. Definitions and functions of promoters.

See, *supra*, ch. 4, p. 374.

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## Sec. 507. Rights of corporation,—duties of promoters.

## CHANDLER v. BACON.

1887. IN THE UNITED STATES CIRCUIT COURT, DISTRICT OF MASSACHUSETTS. 30 Fed. Rep. 538-541.

COLT, J. These cases were heard on exceptions to the master's report. The master found that the defendants Bacon and Caduc were promoters of the National Color Printing Company; that, as such promoters, they negotiated an agreement between the owners of certain patents and the National Color Printing Company to be formed, by which, among other things, they were to receive two-sixteenths, or 3,750 shares, of the capital stock of the new company, less 625 shares, which they were to assign to Robert A. Piper; that the defendants offered to the public an option to take the stock in the new company, disclosing the fact of the purchase of the patents, and that a portion of the stock in the company was to be issued to the former owners of the patents in part payment therefor, but not informing the persons who subscribed for the stock that they were to have stock on any different terms or conditions. The master further finds that, at the time the agreement was signed, an understanding was arrived at between the defendants and the officers of the United States Label, Card and Tag Company, the owners of the patents purchased, that the defendant Bacon should be president of the new company, and the defendant Caduc treasurer, and that, pursuant to this agreement, these officers were elected; that the defendants obtained for themselves these positions, and the control of the books of the new company; that they placed a large amount of stock at the uniform price of seven dollars a share; and that, under the agreement, they obtained 3,125 shares of stock, without paying anything into the treasury of the company, as all other persons did who subscribed for the stock upon the solicitation of the defendants, or upon the solicitation

<sup>1</sup> Inasmuch as the topics touched upon in the following chapters are more fully developed in the cases given (or those preceding), and the doctrines relating thereto are easily accessible in all the text-books, only few references to late cases will be hereafter given.

of other persons whom the defendants had interested in said company. The master further finds that the defendants were partners, and that they should pay the receiver at the rate of seven dollars per share for each of the 3,125 shares of stock received by them, with interest from September 23, 1880, amounting to the total sum of \$28,794.78, less \$17,289.55, the amount the master finds, in cause No. 1,790, the defendant Caduc advanced to the company. The defendants object to the finding of the master that they received 3,125 shares to their own use, without payment of seven dollars per share, because they say that he disregards the fact that said shares had been fully paid for, and that the Color Printing Company had received full value therefor, and that the United States Circuit Court of New Jersey had decreed that these shares were fully paid and properly issued. It appears that Judge Nixon, upon an application by the present receiver, held that these shares in question were full-paid stock for the property purchased, and therefore not liable to assessment, but he also subsequently said that no decision was made as to the validity of the issue of this stock to these defendants, and it was his intention simply to instruct the receiver not to assess this stock.

The question before us now is not whether these shares are to be considered as full-paid stock, but whether these defendants, as promoters of the new company, could take them without consideration, while other stockholders paid seven dollars per share. Clearly, they could not lawfully do this. As promoters of the new company, they occupied a fiduciary relation towards it similar to that of agent to a principal, and they had no right in these negotiations to derive any advantage over other stockholders without a full and fair disclosure of the transactions, and any secret profits so made they must refund to the company. That this may have been done without any fraudulent intent, or that the price paid for the patents was fair and reasonable, can not relieve these defendants. The law forbids them, from their position, to secretly derive any benefit over other stockholders, and makes them accountable to the company for any profit so derived. *Bagnall v. Carlton*, 6 Ch. Div. 371; *Whaley, etc., Co. v. Green*, 5 Q. B. Div. 109; *New Sombrero Phosphate Co. v. Erlanger*, 5 Ch. Div. 73; *Emma Silver Min. Co. v. Grant*, 11 Ch. Div. 918; *Densmore Oil Co. v. Densmore*, 64 Pa. St. 43; *McElhenny's Appeal*, 61 Pa. St. 188; *Simons v. Vulcan Oil, etc., Co.*, 61 Pa. St. 202; *Emery v. Parrott*, 107 Mass. 95; *Getty v. Devlin*, 54 N. Y. 403.

The finding of the master that the defendants should pay seven dollars a share is objected to as without warrant of law, and it is contended that the defendants are only liable to account for the shares themselves, or for the profit, if any, they have made upon them. I think the company had a right to elect (1) whether they would have the shares transferred back to them; or, (2) if the shares had been sold, that these defendants should turn over the entire profit made by the sale; or, (3) that the company may say: "Although you may have derived no profit by selling the shares, yet you deprived us of placing them with other persons, and you must therefore pay us the



sum we have lost by reason of our being deprived of the right of placing these shares with other persons." Carling's Case, 1 Ch. Div. 115, 126, 127; McKay's Case, 2 Ch. Div. 1; De Ruvigne's Case, 5 Ch. Div. 306; Nant-y-glo, etc., Co. v. Grave, 12 Ch. Div. 738. The last measure of damages has been adopted by the master in this case. It is in proof that a large amount of the stock of the company was placed at a uniform price of seven dollars a share, and the defendants are called upon to account for their stock at this price. I can see no error in this finding of the master.

As to the third exception, the master properly said that there was no evidence that the defendant Bacon, upon request of the plaintiff, delivered up to him, before the proceedings, 750 of the shares in question, and that, therefore, Bacon must be charged as found.

The remaining exception is to the master's finding that the defendants were partners, and as such are jointly and severally liable to the complainant. These defendants signed the secret agreement as parties of second part, and they were acting in concert to promote a common purpose for their common benefit, and consequently they were jointly and severally liable to account to the complainant. When the conduct of parties operates as a fraud or deceit upon third persons, whatever their private intention, the relation of partnership may be said to exist as to such third persons. Story Partn., section 49; Emery v. Parrott, 107 Mass. 95.

*Exceptions overruled.*

*Note.* See note, *supra*, p. 375. 1887, St. Louis, Ft. Scott, etc., R. Co. v. Tiernan, 37 Kan. 606, *supra*, p. 375; 1889, Pittsburgh M. Co. v. Spooner, 74 Wis. 307; 1896, Woodbury Heights v. Loudenslager, 55 N. J. Eq. 78, and compare this with, 1898, Loudenslager v. Woodbury Heights Co., 56 N. J. Eq. 411, 41 Atl. Rep. 1115, and, 1899, Woodbury Heights L. Co. v. Loudenslager, 58 N. J. 558, 43 Atl. Rep. 671; 1899, Lagunas Nitrate Co. v. Lagunas Nitrate Syndicate, 68 L. J. Ch. 699, 81 L. T. (N. S.) 334, 48 Weekly Rep. 74; 1900, Hayward v. Leeson, 176 Mass. 310, 49 L. R. A. 725.

## Sec. 508. Liability of promoters to the corporation and shareholders.

HEBGEN AND OTHERS, RESPONDENTS, v. KOEFFLER, APPELLANT.<sup>1</sup>

1897. IN THE SUPREME COURT OF WISCONSIN. 97 Wis. Rep. 313-321.

[Appeal from circuit court. The action was to rescind a sale of real estate on the ground of fraud, and to recover of the promoters of a corporation profits alleged to have been fraudulently made by them. The decision was for plaintiff upon findings made.]

MARSHALL, J. There is no controversy but that the judgment appealed from is sustained by the findings of fact and conclusions of law.

<sup>1</sup> Statement, except as given in the opinion, omitted.

Questions of law are discussed in the briefs of counsel but not reached in the consideration of the case, unless some of the findings of fact, to which reference will be made, are first disturbed. The findings, as they stand, are to the effect that defendant Hugo Koeffler, at an expense of \$6,000, obtained the right to purchase of Van Eimeren a tract of land for \$31,000, payable \$600 down, \$13,400 January 2, 1893, and the balance January 2, 1898, with interest; that he then associated with him defendant Preusser in a scheme to form a corporation to take the land for \$55,000 and to divide the profits of the transaction between himself and Preusser, two-thirds to the former and one-third to the latter; that pursuant to such scheme they prepared a subscription paper so worded as not to disclose the true ownership of the land, but to induce signers to believe that it belonged to Van Eimeren, and to bind them to join in forming a corporation to purchase such land for \$55,000, payable \$25,000 down, \$13,000 January 2, 1895, and \$17,000 January 2, 1898, with annual interest; that in order to induce signers not in the scheme to believe that the promoters purposed becoming stockholders on the same basis as others who joined in the apparently mutual enterprise, they each signed for \$10,000 of the stock, and one Fernekes, who was employed to assist in obtaining subscriptions, signed for \$3,000, to make it appear that he was going in with others, while such subscription was in fact for Koeffler; that the whole stock of \$55,000 was subscribed and the corporation was thereupon organized; that Koeffler and Preusser procured themselves to be elected as directors and managing officers, and the sale of the real estate to the corporation to be consummated, ostensibly by Van Eimeren, for \$55,000, but really for \$31,000, the promoters taking the difference over the cost to them for profits of the deal, without the other stockholders having any idea but that the purchase was made of Van Eimeren for the full sum of \$55,000.

It needs no discussion of the subject to show that such facts make a clear case for relief against the promoters, either in equity, by or for the benefit of the corporation, to rescind the sale and recover the consideration paid for the property, or in any one of the several other ways that might have been adopted. *Pittsburg Mining Co. v. Spooner*, 74 Wis. 307; *Fountain Spring Park Co. v. Roberts*, 92 Wis. 345; *Franey v. Warner*, 96 Wis. 222. The last case cited was very recently decided by this court and the subject there fully discussed and the law stated in substance that, "if a person invites others to join him in the purchase of property at a given price, falsely representing that the purchase is to be made of a third person and that all are to share equally in the cost and equally in the benefits of the enterprise, and such others join with such person on the faith of such representations, and the purchase be made accordingly, each of the *bona fide* purchasers paying his proportion of the money, and such person acquires secretly a profit to himself by reason of having obtained the property after the making of the mutual agreement at a less sum than the price made to his associates, or by reason of having acquired the property himself at a less price before the sale, it is a fraud

upon such others, and each may, by restoring such person to his original situation, rescind the transaction and recover his money in an action at law, or he may offer to rescind, and, by keeping such offer good, sue in equity for a rescission of the contract and for a recovery of his money, or, without restoring, he or all similarly interested joining, may sue in equity to charge such person as trustee of the profits fraudulently retained by him, and for an accounting; or each may sue such person at law for damages for the fraud to the extent of the enhanced value he paid by reason thereof. A person so circumstanced stands in a relation of trust and confidence to all his *bona fide* associates, and holds all the profits secretly made for the common benefit of all engaged in the common enterprise, in proportion to their respective interests; and such is the case whether the purchase be made by such person before or after the agreement for the mutual enterprise."

*Affirmed.*

See note to preceding case.

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#### Sec. 509. Promoters' liability to shareholders.

ENGLISH, JUDGE, IN RICHARDSON ET AL. V. GRAHAM ET AL.

1898. IN THE SUPREME COURT OF APPEALS OF WEST VIRGINIA.  
45 W. Va. Rep. 134-142, on 140-141.

The entire controversy in this case grows out of the fact that Graham purchased the ten acres of land in the proceeding mentioned, or obtained an option thereon at six thousand dollars, and, having it at that price, proposed to get up a joint stock company, and sell it to them at eight thousand five hundred dollars. This he had a perfect right to do if he could get the company after it was organized to accept it at that price. It could not concern the company or any of its stockholders what the property originally cost Graham, if they were willing to take it, and did agree to take it, at eight thousand five hundred dollars. After it was ascertained by some of the stockholders that the property cost Graham only six thousand dollars, they seemed to think he ought to have sold it to the company at the same price. The option, however, was Graham's property, and he had a right to sell it for all he could obtain for it. Can we say that Graham deceived the subscribers for stock in this company as to the price he expected the company to pay for the property? Certainly not, when the evidence shows that at the head of the subscription list appeared the following statement in writing: "The real estate contemplated to be operated by the oil company when formed is situated in Pleasants county, West Virginia, containing ten acres, and generally described as part of the T. J. Cook estate at Vaocluse, for which I hold the option, and agree to sell all my rights therein to said company, for eight thousand five hundred dollars, when said company is organized"

—dated October 11, 1890, and signed, "A. B. Graham." So that every subscriber who took stock had an opportunity to read the above statement when he signed the subscription list if he desired, and, if he signed without reading, he had no one to blame but himself.

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**Sec. 510. Liability of the corporation upon promoters' contracts.**

**McARTHUR v. TIMES PRINTING COMPANY.**

1892. IN THE SUPREME COURT OF MINNESOTA. 48 Minn. Rep. 319-322, 31 Am. St. Rep. 653.

MITCHELL, J. The complaint alleges that about October 1, 1889, the defendant contracted with plaintiff for his services as advertising solicitor for one year; that in April, 1890, it discharged him in violation of the contract. The action is to recover damages for the breach of the contract. The answer sets up two defenses: (1) That plaintiff's employment was not for any stated time, but only from week to week; (2) that he was discharged for good cause. Upon the trial there was evidence reasonably tending to prove that in September, 1889, one C. A. Nimocks and others were engaged as promoters in procuring the organization of the defendant company to publish a newspaper; that, about September 12, Nimocks, as such promoter, made a contract with plaintiff, in behalf of the contemplated company, for his services as advertising solicitor for the period of one year from and after October 1,—the date at which it was expected that the company would be organized; that the corporation was not, in fact, organized until October 16, but that the publication of the paper was commenced by the promoters October 1, at which date plaintiff, in pursuance of his arrangement with Nimocks, entered upon the discharge of his duties as advertising solicitor for the paper; that after the organization of the company he continued in its employment in the same capacity until discharged, the following April; that defendant's board of directors never took any formal action with reference to the contract made in its behalf by Nimocks, but all of the stockholders, directors, and officers of the corporation knew of this contract at the time of its organization, or were informed of it soon afterwards, and none of them objected to or repudiated it, but, on the contrary, retained plaintiff in the employment of the company without any other or new contract as to his services.

There is a line of cases which hold that where a contract is made in behalf of, and for the benefit of, a projected corporation, the corporation, after its organization, can not become a party to the contract, either by adoption or ratification of it. *Abbott v. Hapgood*, 150 Mass. 248, 22 N. E. Rep. 907; *Beach Corp.*, section 198. This, however, seems to be more a question of name than of substance; that is, whether the liability of the corporation, in such cases, is to be

placed on the grounds of its adoption of the contract of its promoters, or upon some other ground, such as equitable estoppel. This court, in accordance with what we deem sound reason, as well as the weight of authority, has held that, while a corporation is not bound by engagements made on its behalf by its promoters, before its organization, it may, after its organization, make such engagements its own contracts. And this it may do precisely as it might make similar original contracts; formal action of its board of directors being necessary only where it would be necessary in the case of a similar original contract. That it is not requisite that such adoption or acceptance be expressed, but it may be inferred from acts or acquiescence on part of the corporation, or its authorized agents, as any similar original contract might be shown. *Battelle v. Northwestern Cement and Concrete Pavement Co.*, 37 Minn. 89, 33 N. W. Rep. 327. See, also, *Mor. Corp.*, section 548. The right of the corporate agents to adopt an agreement originally made by promoters depends upon the purposes of the corporation and the nature of the agreement. Of course, the agreement must be one which the corporation itself could make, and one which the usual agents of the company have express or implied authority to make. That the contract in this case was of that kind is very clear; and the acts and acquiescence of the corporate officers, after the organization of the company, fully justified the jury in finding that it had adopted it as its own.

The defendant, however, claims that the contract was void under the statute of frauds, because, "by its terms not to be performed within one year from the making thereof," which counsel assumes to be September 12,—the date of the agreement between plaintiff and the promoter. This proceeds upon the erroneous theory that the act of the corporation, in such cases, is a ratification, which relates back to the date of the contract with the promoter, under the familiar maxim that "a subsequent ratification has a retroactive effect, and is equivalent to a prior command." But the liability of the corporation, under such circumstances, does not rest upon any principle of the law of agency, but upon the immediate and voluntary act of the company. Although the acts of a corporation with reference to the contracts made by promoters in its behalf before its organization are frequently loosely termed "ratification," yet a ratification properly so called, implies an existing person, on whose behalf the contract might have been made at the time. There can not, in law, be a ratification of a contract which could not have been made binding on the ratifier at the time it was made, because the ratifier was not then in existence. In *re Empress Engineering Co.*, 16 Ch. Div. 128; *Melhado v. Porto Alegre, N. H. & B. R. Co.*, L. R. 9 C. P. 505; *Kellner v. Baxter*, L. R. 2 C. P. 185. What is called "adoption," in such cases, is, in legal effect, the making of a contract of the date of the adoption, and not as of some former date. The contract in this case was, therefore, not within the statute of frauds. The trial court fairly submitted to the jury all the issues of fact in this case, accompanied by instructions as to the law which were exactly in the

line of the views we have expressed; and the evidence justified the verdict.

The point is made that the plaintiff should have alleged that the contract was made with Nimocks, and subsequently adopted by the defendant. If we are correct in what we have said as to the legal effect of the adoption by the corporation of a contract made by a promoter in its behalf before its organization, the plaintiff properly pleaded the contract as having been made with the defendant. But we do not find that the evidence was objected to on the ground of a variance between it and the complaint. The assignments of error are very numerous, but what has been already said covers all that are entitled to any special notice.

*Order affirmed.*

*Note.* See, 1874, *Western Screw Co. v. Cousley*, 72 Ill. 531; 1900, *Chase v. Redfield Creamery Co.*, 12 S. D. 529, 81 N. W. Rep. 951; 1900, *Hayward v. Leeson*, 176 Mass. 310, 49 L. R. A. 725.

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**Sec. 511.** Liability of promoters to parties with whom they contract.

**WEATHERFORD M. W. & N. W. R. CO. v. GRANGER.<sup>1</sup>**

1894. IN THE SUPREME COURT OF TEXAS. 86 Texas 350, 24 S. W. 795.

GAINES, J. This suit was brought by the defendant in error against the plaintiff in error to recover upon open account for services rendered. The plaintiff in the trial court obtained a judgment which was affirmed by the court of civil appeals. This writ of error is sued out for the purpose of reversing that judgment. The plaintiff in error, the defendant in the trial court, is a corporation organized under the general law of the state for the purpose of constructing and operating a railroad. The defendant in error, the plaintiff in the trial court, is a practicing attorney at law. \* \* \*

The trial judge, as conclusions of fact, found, in substance, that some kind of a company was formed to build the railroad from Weatherford to Mineral Wells; that Anderson was the "principal mover in said scheme, and was so recognized by all parties;" that he employed plaintiff to assist him in procuring a bonus and in otherwise advancing the enterprise, and that the plaintiff rendered service under said employment both before and after the articles of the company were filed; that the bonus was raised, and was, after its incorporation, accepted by said company. The court of civil appeals

<sup>1</sup> Part of opinion omitted.



adopt the findings of the trial judge, and add additional findings as follows: "The charter of the defendant company was signed and acknowledged about June 1, 1889, and was filed in the office of the secretary of state at Austin July 2, 1889. The bonus or subsidy was not secured until after the filing of the charter. The record would have justified the trial court, and so justifies us, in finding, as we do, the fact to be that in availing itself of the subsidy secured the company knew of the services of the plaintiff in raising the bonus." Under the statute the corporation came into existence when its articles of incorporation were filed in the office of the secretary of state. Revised Statutes, articles 4104, 4105. Although the trial court found that the services for which plaintiff sued were rendered in part before and in part after the filing of the articles, their value was assessed as an entirety at \$500, and judgment was rendered for the whole amount. In this there was error. We are of opinion that, under the circumstances of this case as shown by the evidence, the defendant corporation can not be held liable to the plaintiff for any services rendered by him before it was brought into legal existence.

Upon the question as to the liability of a corporation growing out of contracts made on its behalf by its promoters there is considerable diversity and some conflict of opinion. But there are some propositions affecting this question upon which the authorities seem to be in substantial accord.

The promoter, though he purport to act on behalf of the projected corporation, and not for himself, can not be treated as agent, because the nominal principal is not then in existence; and hence, where there is nothing more than a contract by a promoter, in which he undertakes to bind the future corporation, it is generally conceded that it can not be enforced. *Kelner v. Baxter*, L. R. 2 C. P. 174; *Melhado v. Railway Co.*, L. R. 9 C. P. 503.

The promoters themselves are liable upon the contract, unless the person with whom they engage agrees to look to some other fund for payment. *Kerridge v. Hesse*, 9 Car. & P. 200. The statute, however, which authorizes the incorporation, may provide that the corporation, when formed, shall pay the necessary expenses of promoting the scheme. In such a case, though the right of action is dependent upon the contract, the liability is created by the statute. In *re Rotherham, etc., Co.*, 50 Law T. (N. S.) 219. It is now held in England that, although the articles of association bind the company to pay the expenses of its promotion, a third party can not avail himself of such a provision so as to maintain an action against the company. In *re Rotherham, etc., Co.*, *supra*; *Eley v. Assurance Co.*, 34 Law T. (N. S.) 190.

It is also generally held that contracts by promoters, made on behalf of the corporation within the scope of its general authority, may be adopted by the latter after its organization. Some of the courts say they may be ratified, but ratification presupposes a principal existing at the time of the agent's action, and it seems to us, therefore, that the term is not applicable in its technical sense. *McArthur v. Print-*

ing Co. (Minn.), 51 N. W. 216; Spiller v. Skating Rink Co., 7 Ch. Div. 368.

With the exception of the law courts of England, the rule is also very generally recognized that *if a contract be made on behalf of a corporation by its promoters, and the corporation, after its organization, with a knowledge of the facts, accept its benefits, it must take it with its burdens*; and, if the other party has performed the stipulation binding upon him, it may be enforced as against the corporation. Spiller v. Skating Rink Co., *supra*; Touche v. Warehousing Co., 6 Ch. App. 671. But as to the application of the rule last announced the courts differ in opinion. A leading case upon this subject is Edwards v. Railway Co., 1 Mylne & C. 650. There the promoters of the railway company had entered into a contract with the trustees of a turnpike company, in which the latter agreed to withdraw their opposition to an act of parliament for the incorporation of the railway company, in consideration of an agreement by the promoters to insert certain clauses in the act as to the nature of the necessary constructions at the crossing of the railway and the turnpike road, and the opposition was withdrawn, but the clauses were not inserted; and it was held that the railway company should be enjoined from constructing the crossing in a manner different from that specified in the clauses which had been agreed upon and had been omitted. The correctness of the ruling in this case was seriously questioned in the house of lords in Preston v. Railway Co., 5 H. L. Cas. 605, and in Railway Co. v. Magistrates of Helensburg, 2 Macq. 391, 2 Jur. (N. S.) 695. We presume the doubt as to this case arises from the fact that the only benefit accepted by the defendant company was the exercise of the powers conferred upon it by the act of parliament.

When the promoters of a railway company have agreed with a landed proprietor, through whose estates the road is projected to run, to take the requisite quantity of his land at a stipulated price, and after the corporation is formed it takes the land, it is certainly equitable that the company should be made to pay the agreed compensation; and the doctrine is recognized in many English equity cases. Stanley v. Railway Co., 3 Mylne & C. 773; Gooday v. Railway Co., 15 Eng. Law & Eq. 596; Preston v. Railway Co., 7 Eng. Law & Eq. 124; Edwards v. Railway Co., 1 Mylne & C. 650. The same rule has been announced also in many American cases. Railway Co. v. Perry, 37 Ark. 164; Paxton Cattle Co. v. First Nat. Bank, 21 Neb. 621, 33 N. W. 271; Manufacturing Co. v. Small, 40 Md. 395; Bommer v. Spring, etc., Co., 81 N. Y. 468; Battelle v. Pavement Co., 37 Minn. 89, 33 N. W. 327; McArthur v. Printing Co., *supra*. Having exercised rights and enjoyed benefits secured to it by the terms of a contract made by its promoters in its behalf, a corporation should be held estopped to deny its validity.

Again, when the promoters of a corporation have made a contract in its behalf, to be performed after it is organized, it may be deemed a continuing offer on part of the other party to the agreement, unless withdrawn by him, and may be accepted and adopted by the corpora-

tion after such organization; and the exercise of any right inconsistent with the non-existence of such contract might be deemed conclusive evidence of such adoption. But there are some cases which go a step further. *Low v. Railroad Co.*, 45 N. H. 370, was a case of a Vermont corporation sued in New Hampshire upon a contract made in the former state. After a charter had been granted, but before an organization had been effected, a public meeting was held to promote the enterprise, at which, it is to be presumed from the opinion, the corporators were present or were represented. A proposition was made that the plaintiff should be employed, and paid to visit various towns and cities to interest capital in the projected scheme, and to solicit and procure subscriptions. The plaintiff accepted the offer and performed the services; and it was held that the corporation was liable. The court determined that the question of liability depended upon the law of Vermont as announced in the case of *Hall v. Railway Co.*, 28 Vt. 401. But they were also inclined strongly to think that upon general principles the company, by accepting subscriptions, which were procured by the plaintiff, bound itself to pay for his services. They also seem to recognize the doctrine that after a charter has been granted a majority of the corporators have the power to make contracts necessary to perfect the organization, which may be binding upon the company when formed. But they also lay stress upon the fact that the charter of the defendant corporation provided that "the expenses of all surveys and examinations, as also of the preliminary surveys already made and making, and all manner of incidental expenses relating thereto, shall be paid by said corporation." In *Hall v. Railway Co.*, *supra*, a corporator was held entitled to recover for necessary services in organizing the company, although there was no express promise by any one that he should be paid. Unless the charter of the company provided for the payment of such expenses, this decision, we think, is unsupported by authority.

It is generally held that, in the absence of such provision in the act of incorporation, in case of a special charter, or in the general law, or in the articles of incorporation under a general law, no implied promise can be imputed to a corporation to pay for the services of a corporator or promoter before the corporation comes into existence. A contract made by promoters may be adopted by a corporation, expressly or impliedly, by exercising rights under it; but otherwise it is not binding upon such corporations. *Kelner v. Baxter*, *supra*; *Melhado v. Railway Co.*, *supra*; *Railway Co. v. Ketchum*, 27 Conn. 170; *Kerridge v. Hesse*, 9 Car. & P. 200; *Munson v. Railroad Co.*, 103 N. Y. 58, 8 N. E. 355; *Morrison v. Mining Co.*, 52 Cal. 306; *Gent v. Insurance Co.*, 107 Ill. 652; *Railway Co. v. Sage*, 65 Ill. 328; *Manufacturing Co. v. Cousley*, 72 Ill. 531; *Buffington v. Bardon*, 80 Wis. 635, 50 N. W. 776. See, also, *Railway Co. v. Magistrates of Helensburg*, 2 Macq. 391, 2 Jur. (N. S.) 695; *Tift v. Bank*, 141 Pa. St. 550, 21 Atl. 660.

Now, when it is said that when a corporation accepts the benefit of a contract made by its promoters it takes it *cum onere*, it is important

to understand distinctly what is meant. There is, so far as this matter is concerned, a radical difference between a promise made on behalf of the future corporation in the contract itself, the benefits of which the corporation has accepted, and the promise in a previous contract to pay for services in procuring the latter to be made. This is well illustrated by the facts of the present case. Here a proposition was made upon behalf of the company, by its promoters, that if a bonus should be subscribed and paid to it, it would build its road between certain points, and would carry coal at a certain stipulated rate. By accepting the bonus, the company became bound to fulfill the stipulations of that contract. That was the burden which it took with the benefit of the agreement. But it also appears that one of the promoters promised the plaintiff that if he would assist in procuring subscribers to the bonus the company would pay him for his services. This was no part of the contract the benefits of which were taken by the defendant. The benefits of a contract are the advantages which result to either party from a performance by the other, and in like manner its burdens are such as its terms impose. A more accurate manner of stating the nature of the plaintiff's demand is to say that the defendant has accepted the benefit of the plaintiff's services, and should pay for them. It is true in one sense that the company has had the benefit of plaintiff's services, and it is equally true that it would have had that benefit if the services had been rendered under an employment by the subscribers to the bonus; and yet in the latter case it could not be claimed that the company would be liable for such services unless payment for them by the company were made one of the terms of the contract between the company and the subscribers. In *re Rotherham, etc., Co.*, 50 Law T. (N. S.) 219, in the opinion of one of the justices, this language is used: "It is said that Mr. Peace has an equity against the company because the company had the benefit of his labor. What does that mean? If I order a coat and receive it, I get the benefit of the labor of the cloth manufacturer, but does any one dream that I am under any liability to him? It is a mere fallacy to say that because a person gets the benefit of work done by somebody else he is liable to pay the person who did the work." There is more doubt as to the plaintiff's right to recover for his legal services in advising as to the articles of incorporation, and in correcting and preparing this paper. Such services are usually necessary, and it would seem that the corporation should pay for them. Such payment is frequently provided for in the act of incorporation or in the articles when the incorporation is effected under a general law. When such is the case, persons who take stock in the company are chargeable with notice that a liability for this purpose has already been created, and it is proper for the corporation to discharge it. But, in the absence of such provision in the statute or in the articles, it may be unjust to shareholders to charge the corporation with liabilities of which they had no actual knowledge at the time they accepted the shares. We therefore hold with some hesitation that claims for the necessary expenses of the organization

under our statute should not be excepted from the general rule applicable to contracts made before the corporation has come into legal existence.

Applying the rules we have announced to the case before us, it is apparent that the plaintiff has recovered, in part at least, for services for which the defendant was not bound to pay. He made his contract before the company had a legal existence as a corporation, with a single promoter; and it is a matter of no moment that the promoter was the general manager of the project, and became the owner of the majority of the stock upon its organization. There were other stockholders. The law requires that there should be ten at least. Rev. St., article 4099. The evidence does not disclose that his contract with Anderson was actually known to any other person, nor do we see any other circumstance from which knowledge should necessarily be inferred. Since Anderson had no power to bind the future corporation, but could bind himself, the inference from his assisting Anderson would be that he was acting gratuitously, or that Anderson had agreed to pay him. Anderson was interested in shifting his contract upon the company, and it may be doubted whether, although he became a director, notice to him could be deemed notice to the company. The court of civil appeals find, however, that the company had notice. Waiving the question of the right of the court to supplement the finding of the trial judge under such evidence, and the further question whether there be any evidence to support this conclusion, it follows from what we have already said that the question of the company's knowledge does not affect the case. The plaintiff's contract with Anderson, though made by latter on behalf of the company, was not a lien, incumbrance, or burden upon the contract between the subscribers to the bonus and the defendant, and it incurred no liability on the former contract by accepting the benefit of the latter. The evidence was sufficient to sustain a recovery by the plaintiff for the value of his services rendered after the corporation was created; but the court below failed to find separately the reasonable worth of such services. Therefore the entire judgment must be reversed.

*Reversed.*

Compare 1902, Friedman v. Jansen, — Ky. —, 68 S. W. 752.

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### Sec. 512. Liability of corporation to promoter for expenses incurred in promoting corporation.

See Marchand v. Loan Association, 26 La. Ann. 389, *supra*, p. 383.

*Note.* Compare, 1900, Hayward v. Leeson, 176 Mass. 310, 49 L. R. A. 725, 57 N. E. Rep. 656.

SUBDIVISION II. THE CORPORATION AND ITS MEMBERS OR SHAREHOLDERS.

ARTICLE I. RIGHTS OF THE CORPORATION.

Sec. 513. 1. To corporate existence,—estoppel of members to deny corporate existence.

See *Foster v. Moulton*, 35 Minn. 458, *supra*, p. 646; *Canfield v. Gregory*, 66 Conn. 9, *supra*, p. 647; *McCarthy v. Lavasche*, 89 Ill. 270, *supra*, pp. 253, 650.

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Sec. 514. 2. To issue preferred stock, or increase or decrease the capital stock.

See *Kent v. Quicksilver Min. Co.*, 78 N. Y. 159, *supra*, p. 790; *Railway Co. v. Allerton*, 85 U. S. (18 Wall.) 233, *supra*, pp. 442, 763; *Droitwich Salt Co. v. Curzon*, L. R. 3 Exch. 35, *supra*, p. 764.

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Sec. 515. 3. To enforce contracts of subscription.

(a) General relation of shareholders to the corporation, to other shareholders, and to creditors; subscription induced by fraud.

C. W. UPTON, ASSIGNEE, ETC., v. ANDREW ENGLEHART.<sup>1</sup>

1874. IN THE UNITED STATES CIRCUIT COURT, DISTRICT OF IOWA.  
3 Dillon's Rep. 496-511.

[Suit by Upton, assignee in bankruptcy of an insurance company, against Englehart to collect an alleged unpaid subscription to the capital stock of the company. The answer alleged that the company was chartered in Illinois, and sent its agent to Iowa to procure its stock to be taken. It is alleged that this agent made false and fraudulent representations of a material character to induce defendant to agree to become a shareholder; viz.: "that \$20 per share would be full payment for the stock, and that the remaining 80 per cent. was 'non-assessable;' " and such was defendant's written agreement with the company, the certificate received being marked "non-assessable," though not otherwise indicating it was fully paid. The answer also stated that defendant's purchase of the stock was induced by these fraudulent representations, and that "he long ago repudiated the same by refusing to pay any more" of the installments. This answer was demurred to.]

<sup>1</sup> Statement abridged. Part only of the opinion given.



DILLON, Circuit Judge. Whoever becomes a stockholder in an incorporated company sustains a three-fold relation: *First*, to the artificial person called the corporation. *Second*, to the other stockholders in the same company, or in other words, his associates or partners, who by force of statute are clothed with corporate capacity. And *third*, to the creditors of the corporation. It is essential to bear these several relations in mind in determining the questions here presented. The capital is supplied by the shareholders, who alone participate in the gains or pecuniary advantages which may accrue from the carrying on of the corporate enterprise. The shareholders are the real parties in interest; the incorporating statute empowering them to contract and be contracted with through the medium of a corporate representative. \* \* \*

And here the plea may be considered in a double aspect: *First*, does it set forth a sufficient answer if the action were one by the company before insolvency to enforce payment for the stock? *Second*, does it set forth a sufficient answer to such an action when brought in the interest of creditors of the company after it has failed?

Assuming that the statements in the plea are true, it appears that the defendant was induced to agree to become a shareholder by false and deceptive statements of the agent, and even of the company itself, as shown by the character of the certificate it issued. The effect of fraud practiced to induce a contract to subscribe to stock or purchase shares is, as respects the company and the person deceived, the same as in other contracts, with the modifications arising from the peculiar nature of the transaction as to repudiating or rescinding the contract, which will be adverted to further along. Speaking of contracts to become a shareholder, induced by the fraud of the company or its agents, Lord Romilly says: "Contracts of this description between an individual and a company, so far as misrepresentation or suppression of truth is concerned, are to be treated like contracts between any two individuals. If one man makes false statement which misleads another, the way in which that is to be treated affords the example for the way in which a contract is to be treated where a company makes a false statement which misleads an individual." *Directors, etc., of Central Railway of Venezuela v. Kisch*, Law Rep. 2 H. L. 99, 125, 1867; *Smith's Case*, L. Rep. 2 Ch. App. 604, 609. \* \* \*

The fraudulent representation or concealment must, of course, relate to material facts, but if it does, and has induced a person using reasonable caution and judgment to enter into a contract to purchase shares, it is ordinarily no answer to his claim to be relieved of the contract that by more vigilance he might have discovered the deception. This point is expressly adjudged by the house of lords in the *Directors, etc., of the Central Railway Co. of Venezuela v. Kisch*, Law Rep. 2 H. L. 99, 1867. \* \* \*

Considering that the transaction between the defendant and the company's agent set up in the plea took place in a state different from that in which the company was organized, and that its charter was on file in the auditor's office in Illinois, it is our opinion that it would be

possible for the agent of the company to make fraudulent representations concerning the laws of Illinois and the charter of the company, and that if he did represent that, by those laws and the charter, eighty per cent. of the stock was "non-assessable," and the defendant relied upon this, he is entitled, in the absence of laches and acquiescence, as against the company, to resist payment of this eighty per cent. In this connection, it may be mentioned that it is the duty of a person who has been fraudulently drawn into the purchase of shares to take prompt measures on discovering the fraud to repudiate or rescind the contract. And the reason for this is two-fold: 1. Because his remaining in the company may mislead others into becoming members of it upon the credit of his name, when otherwise they would not do so. 2. Because it may likewise induce others to deal with it and give credit to it for the same reason. *Directors, etc., v. Kisch, supra*; *Bwlch-y-Plwm & Co., L. R. 2 Exch. 326*; *Ashley's Case, L. R. 9 Eq. 262*; *Scholey v. Central Railway Co. of Venezuela* (bill by shareholders against company), *L. R. 9 Eq. 267*, note, decided by Lord Chancellor Cairns. In the case last cited the Lord Chancellor said: "He certainly thought that the court would be most careful to see, in a company going on and trading, in which the rights of shareholders and others varied from day to day, that a person coming to complain of misrepresentations of this kind, and coming to avoid a voidable contract, came within the shortest limit of time which was fairly possible in such a case." It results from the foregoing considerations that if this were an action by the company for calls, or a suit by the defendant against the company to rescind the contract for the purchase of stock, and the facts were as set out in the answer, the law would be with the present defendant, provided it appeared that he had been guilty of no laches in discovering the fraud, and thereupon promptly repudiated the contract. How the contract may be repudiated or disaffirmed, see *Bwlch-y-Plwm & Co. (sufficiency of plea), L. R. 2 Exch. 324*; *Ashley's Case, L. R. 9 Eq. 263*; *McNiell's Case, L. R. 10 Eq. 503*; observations of Lord Chancellor Hatherley in *Smith's Case, L. R. 4 H. L. 64*, on p. 73; Lord Westbury in *S. C.*, p. 77, 78; Lord Cairns, in *S. C.*, p. 70, *S. C.* below, *L. R. 2 Ch. App. 604*; *Oakes v. Turquand, supra*, and cases cited, *infra*.

It remains to consider how far the foregoing principles are modified when the company has failed or become bankrupt and the rights of creditors, in addition to those of shareholders, are involved. As respects creditors, "the stockholders are special partners, incorporated to carry on the business of the company, and the stock subscribed and secured by the several stockholders or partners constitutes the capital or fund publicly pledged to all who deal with them," and the stockholders are debtors to the company for their unpaid stock. *Ogilvie v. Knox Ins. Co., 22 How. 380, 387*.

Assuming this to be, as it unquestionably is, a correct view of the relation of stockholders to the company and to the public, the argument is made on behalf of the defendant, that if he was induced by

the fraud of the company to agree to purchase its stock, he does not thereby become a stockholder, because an agreement obtained by fraud is void, and the person so injured has a right to repudiate it and treat it as utterly invalid from the beginning, as regards the company, and that the company's creditors have in this respect no higher right than the company itself. In other words, if the company has no right to collect the subscription or purchase-money for the shares, its creditors, who are not creditors of the subscriber to the stock or the shareholder, must claim through it and can stand on no better ground, and the right of the assignee in bankruptcy, as the representative of creditors, is simply the right to collect the assets of the company, and if the person claimed to be a stockholder is not, by reason of fraud, entitled to be held as such by the company, this answers any possible right of the assignee to a recovery. But the proposition is not a sound one, that the right of a person who has been drawn into the purchase of stock by the fraud of a company or its agents to relief is as great against creditors as it would be against the company. If the contest is with the company, it is essentially one with the alleged shareholder's own partners or associates, and if their corporate representative or its agents have practiced a fraud upon him, he is entitled to relief against it. But if a person has accepted a certificate of stock and becomes, to all external appearance, a stockholder, persons may have become creditors of the company on the faith of his membership, and in law are presumed to do so, and as they can not know the manner in which he was induced to become a stockholder, there is ground to maintain that as to them the manner is immaterial.

Upon consideration of the adjudged cases, and upon principle, our judgment is that a contract to purchase shares induced by fraudulent representations or concealment is not void, but only voidable, which means, as the house of lords has decided, that it is valid until disaffirmed, and not that it is void until affirmed. *Oakes v. Turquand, supra*; *Reese, etc., Mining Co. v. Smith*, L. R. 4 H. L. 64; S. C. case below, L. R. 2 Ch. App. 604.

This doctrine, it will be seen, gives to the purchaser of shares, though his purchase was induced by fraud, the right to hold on to them if it should be profitable to do so; and as the rights of creditors may become involved, who can ordinarily know nothing of the fraud practiced upon the shareholder, the law as a condition of relief to the latter requires that he shall be guilty of no *laches* in discovering the fraud and in repudiating the purchase.

Speaking of this subject, Lord Romilly, in *Ashley's Case*, above cited, after referring to the course of decision, says: "The leading principle in all these cases is this: A man must not play fast and loose; he must not say 'I will abide by the company if successful, and I will leave the company if it fails;' and therefore when a misrepresentation is made of which any one of the shareholders has notice, and can take advantage to avoid his contract with the company, it is his duty to determine at once whether he will depart from the

company or whether he will remain a member." L. R. 9 Eq. 262, 268; McNiell's Case, L. R. 10 Eq. 503, 1870. \* \* \*

The plea is defective in that it does not show that the defendant made use of reasonable diligence to make himself acquainted with the matters of fact in respect of which the fraud is claimed, nor when or how he repudiated the contract, nor whether he offered to surrender the certificate of stock promptly on discovering the fraud.

For these reasons the demurrer to the second special defense or plea is sustained.

*Demurrer sustained.*

Love, J., concurred.

*Note.* 1902, Anglo-Am. Land, etc., Co. v. Dyer, 181 Mass. 593, 92 Am. St. R. 437; see also, note, 93 Am. St. R. 349; as to liability to creditors, see Martin v. South Salem Land Co., *supra*, 539.

Sec. 516. Same. (b) Assumpsit, misrepresentations, release, change of amount of stock, subscription of the whole amount.

HUGHES v. THE ANTIETAM MANUFACTURING COMPANY OF WASHINGTON COUNTY.<sup>1</sup>

1870. IN THE COURT OF APPEALS OF MARYLAND. 34 Md. Rep. 316-332.

[Action of assumpsit by the company against Hughes to recover certain unpaid installments alleged to be due on a subscription to the capital stock. The court below found for the company; the errors assigned by the appellant were certain charges to the jury at the request of the company, and the failure to charge as requested by appellant. Of the former, among others, the court charged that if the jury found that calls for payment were made as stated, "of which the defendant had notice, or of which notices directed to the defendant were left in his postoffice, and the defendant had refused to pay the same," plaintiff could recover; and among the latter Hughes asked that if the jury found that at any time after he had signed the subscription paper which stated the amount of capital stock to be \$50,000, it had been changed without his knowledge to \$150,000, and he had never assented to it, he could not be held; the court changed this by saying if the change had been made "after same was acknowledged by the defendant," then he would not be liable. The third charge, which the court refused to give, asked that if the jury should find that defendant was induced to subscribe by representations that "at least six per cent. interest upon said capital would be paid by rents from the Emmert property, to be bought by the plaintiff the first year, \* \* \* and should further find the said property was so bought but not rented, but forthwith changed and improved at great expense," then the company could not recover. The eighth charge, which also was refused, asked that

<sup>1</sup> Statement abridged; only part of opinion given.

if there had been other subscribers to the stock who had been released without his consent, he could not be held upon his subscription.]

ROBINSON, J. \* \* \* But conceding the validity of the subscription, it is contended that an action of assumpsit will not lie, because it does not contain an *express promise to pay*, and that the only remedy against the delinquent subscriber is by a forfeiture and sale of the stock under the 45th section. It may be true that an *express promise* in so many words may not be found in the subscription, but it was made for a *given number of* shares and at a *fixed money value*, and when construed in connection with the law under which the company was to be organized, we are very far from admitting it does not amount to an express promise to pay for the shares in the manner and upon the conditions therein prescribed. The purpose of the appellant and his co-subscribers in signing the articles of association and subscribing for a given number of shares, was to organize a company and furnish capital sufficient to carry on the *manufacturing* business, from the successful prosecution of which they expected to realize a *profit* on the money thus invested. To this end property was to be purchased, materials bought, labor performed, and debts incurred, and these could only be done and accomplished by the payment of the stock subscribed. Forfeiture and sale of the shares might fail to realize the means necessary to effect these objects, and particularly if the prospects of success were not so flattering after the organization as the more hopeful projectors anticipated. If, therefore, no action will lie to enforce the payment of the subscriptions, not only must the object and purposes for which the company was organized fail, but the capital stock of those who have promptly paid, relying upon the good faith of their co-subscribers, must also prove an entire loss. It has been held, it is true, in Massachusetts and New Hampshire, that the only remedy against the delinquent subscriber is by forfeiture and sale of the stock; but in reviewing these decisions, Mr. Redfield says: "They arose under charters in which the capital stock and number of shares were *not fixed*, and he admits it to be firmly established in this country and in England that where the stock of the company is defined and divided into a certain number of shares, a subscription for shares, whether it contains an express promise to pay or not, is regarded as an agreement on the part of the subscriber to pay for the same according to the terms and provisions of the charter, and that the remedy by forfeiture and sale is cumulative merely." 1 Redfield on Railways 163. The many cases referred to by the author fully sustain this general rule, and in one of them, the Hartford and New Haven R. R. Co. v. Kennedy, 12 Conn. 500, where the decisions in Massachusetts relied on by the appellant were ably reviewed, the court say: "The act of becoming a stockholder pursuant to the provisions of this charter, is one from which the law raises a promise to pay the installments legally assessed and demandable. The common law furnishes a remedy for a violation of this engagement by an action of assumpsit. The subsequent enactment authorizing the directors to sell the stock is affirmative in its



terms. It does not expressly or by implication take away the previous remedy which the common law has provided. No words are used indicative of an intention to deprive the corporation of their previous existing remedy—no necessity is perceived why they should be deprived of it—and every consideration arising from public policy or connected with good faith and common honesty demands that this remedy should continue in full force.” \* \* \*

We find no error in the rejection of the appellant's third prayer. In order to avoid the contract of subscription it must appear to have been made upon the *faith of false representations* of the agent, in regard to a *matter of fact, material to the value and success of the enterprise*. The mere statement that the rents of the Emmert property would pay six per cent. on the capital stock for the first year, and then the company could determine whether to build or not, etc., must be regarded as the mere expression of opinion in regard to the success of the undertaking, upon which the appellant had no right to rely. In all probability he was as competent to judge of the success or profits to be realized as the agent, and contracts thus deliberately made, and upon the faith of which others may have acted, are not to be avoided because of the flattering prospects held out by parties soliciting subscriptions.

The appellant's eighth prayer was also properly rejected. This was a joint undertaking, and the consideration of the contract of subscription was the right to share the profits arising therefrom. Under such circumstances a subscriber could neither withdraw nor be released from his subscription without the consent of all the co-subscribers, and the fact that the directors or managers undertook to release certain parties can not operate in any manner to discharge the appellant from his obligation.

The statute under which the appellee was organized confers no such power on the directory, and the exercise of it can not affect, one way or the other, the liability of the subscribers who may have been thus released.

We think, however, the court erred in the modification of the appellant's second prayer. The change of the capital stock from fifty thousand to one hundred and fifty thousand dollars, after his subscription, and without his assent or subsequent acquiescence, discharged him from all liability on account of the same, and the mere acknowledgment by him of the certificate before the justice of the peace, if, at the time, he was ignorant of the change or alteration thus made, can not be construed as a new contract on his part, nor estop him from relying on this defense in a suit by the appellee—the party by whom the change was made.

We think, also, the court erred in regard to the notice prescribed by section 49 of article 26. It has been decided, we are aware, in one or two states, under statutes similar in many respects to the one under which the appellee was organized, that notice of the calls or assessments is only necessary to the forfeiture and sale of the stock; but in referring to these cases, Redfield says: “They are contrary to



the general course of decisions upon the point, and somewhat at variance with the idea of a call or assessment." 1 Redfield on Railways 147, note. To say that it is unnecessary, because the subscribers, who may be living in different parts of the county, and perhaps the state, are presumed in law to know all that is done by the directory, seems to us to be raising a presumption against the truth itself. But apart from these views, we think the forty-ninth section, in express terms, provides that notice shall be given. It says the directors, trustees or managers "may call in and demand from the stockholders respectively, all sums of money by them subscribed, at such times," etc. How demand? It certainly was not the intention of the legislature that it should be made for the first time through a suit, without giving the subscriber an opportunity to pay the installment thus assessed. Nor was such a construction put upon the statute by the appellee, for we find that written notice was mailed to the appellant. The forty-ninth section, however, requires that there should be a "*personal demand*," or "*notice published*, nearest to the place where the business of the corporation shall be carried on." Constructive notice by the mail is not a personal notice, although in some cases, by express statutory provision, it is sufficient to bind parties. Here, however, the manner of giving notice is prescribed by the law under which the calls are made, and it was the plain duty of the directors to have complied strictly with its requirements in this respect. They had no right to dispense with the mode and manner of notice thus prescribed, and where, by positive law, *personal notice* is required, a written notice through the mail is not a compliance with the statute.

There is another objection which, so far as the record discloses, is fatal to the right of the appellee to recover in this suit. The capital stock of the company, and the number of shares, and their par value per share, are fixed in the recorded certificate, and there is no provision, either in the articles of association, or the subscription itself, or the general law under which the appellee was organized, authorizing the directors to make calls or assessments before the whole capital stock is taken. We take the general rule to be, that where the capital stock and the number of shares are fixed in the articles of association or recorded certificate, no valid assessments or calls can be made against a subscriber until all the shares are taken, unless there be a provision to that effect either in the certificate or general law under which the company is organized, and for the reason that the success of the enterprise, and the profits to be realized therefrom, may depend entirely upon having the full amount of the capital taken up. Cabot and West Springfield Bridge Co. v. Chapin *et al.*, 6 Cushing 50; Contoocook Valley Railroad v. Barker, 32 N. H. 370; Fox v. Clifton, 6 Bing. 776; Wontner v. Shairp, 4 Man., Grang. & Scott, 404; Pitchford v. Davis, 5 Meeson & Welsby, 2; Norwich & Lowestoft Comp. v. Theobald, 1 Moo. & Mal. 151, and 1 Red. 176. The author says: "And where the charter of a railway company requires their stock to consist of not less than a given number of shares, assessments can not be made before the required number is taken."

This point was not relied on in the argument, and we do not rest our decision upon it, for although the record shows only about one-third of the stock was taken, it may appear by proof not before us that the whole capital stock was subscribed.

Being of opinion that the court erred in the modification of the appellant's second prayer, and also in granting the appellee's first prayer, so far as regards the notice of the assessments or calls, the judgment will be reversed, and a new trial awarded.

*Judgment reversed, and new trial awarded.*

*Note.* As to limitation of actions upon subscription contracts, see, 1899, *Crofoot v. Thatcher*, 19 Utah 212, 75 Am. St. Rep. 725.

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**Sec. 517. Same. (c) Forfeiture for non-payment.**

**SMALL v. THE HERKIMER MANUFACTURING AND HYDRAULIC COMPANY.<sup>1</sup>**

1849. IN THE NEW YORK COURT OF APPEALS. 2 N. Y. Rep. 330-351.

[Action of assumpsit in the supreme court by the Herkimer Company against Small on his subscription for twenty-one shares of \$100 each to the capital stock of the company. The charter made it the duty of the directors "to call upon the stockholders for payment of their subscriptions at such times and in such proportions as they should see fit, under penalty of *forfeiture to the company of their shares and all previous payments made thereon*, giving notice (as provided) of such call." Small subscribed and the corporation was organized; April, 1834, a 5 per cent. call payable in sixty days, and another of 5 per cent. payable in ninety days were made; in July a 7 per cent. call payable in August, and in October a 73 per cent. call was made, 13 per cent. payable November 10, and 10 per cent on the first of each of the following six months. Suit was brought in December to collect the 40 per cent. then due and unpaid. In March, 1835, a call of the balance of the subscription—10 per cent.—was made, payable May 15, and Small neglecting to pay, the directors, in June, 1836, passed a resolution forfeiting the stock for this call. Small pleaded this resolution and forfeiture in bar of the suit in assumpsit, alleging that the shares were worth more than the amount due with interest; the company demurred to this plea, and the supreme court sustained the demurrer. This is the error assigned.]

<sup>1</sup>Statement abridged; arguments, opinion of Gardiner, J., concurring with Hoyt, J., and dissenting opinion of Jewett, C. J. (Bronson, J., concurring), and part of opinion of Hoyt, J., omitted. Ruggles, Cady, Strong and Shankland, JJ., concurred.

Hoyt, J. The supreme court of this state, by a series of decisions, commencing with the case of *Goshen Turnpike Company v. Hurin* (9 John. 217), has uniformly held that the mere provision in the charter of incorporated companies, similar to the one in this case, allowing the forfeiture of the stock and previous payments, does not deprive the company of their common-law remedy, by action, to recover from the stockholder the amount of his subscription. (14 John. 238.) In this case they have gone further, and held that although the company exercised the right conferred by the statute and forfeited the stock, they may still recover in an action upon the subscription, unless the value of the stock was equal to the amount due upon the subscription. They liken this case to that of a mortgage, and say, that when the mortgagee takes the thing pledged and sells it, or finally converts it to his own use, he is paid so much only towards his debt as the thing sold for, or was worth, at the time of the conversion, and cite 5 Cowen 380, 9 Cowen 346, 4 Wend. 381, 11 Wend. 106; and when the equity of redemption is released, or a strict foreclosure resorted to in any form, then so much is paid as the value of the thing mortgaged, at the time when the title became absolute in the mortgagee, amounts to. This is no doubt the true rule in the case of a mortgage of real or personal estate, and if the company are to be deemed a mortgagee of the stock, and both parties entitled to the rights of mortgagor and mortgagee, I think it would be decisive in favor of the plaintiff.

But I do not think this is to be regarded in the light of a mortgage. Upon a foreclosure and sale of property mortgaged, if it bring more than the debt the mortgagor is entitled to the surplus. But no provision is made for the company's refunding the surplus in this case. And if the company after forfeiture should sell the stock for a sum beyond the amount unpaid thereon at the time of forfeiture, the defendant could not recover such surplus. Again, in all cases of a mortgage, the mortgagor has in equity a right of redemption until a strict foreclosure, or a foreclosure and sale of the mortgaged property. But no such remedy exists for the redemption of stock forfeited under the provisions of a statute like the one in question. Judge Story (Eq. Juris., section 1325) says that courts of equity in cases of non-compliance by stockholders with the terms of payment of their installments of stock at the times prescribed, by which a forfeiture of their shares is incurred under the by-laws of the institution, have refused to interfere, by granting relief against such forfeiture. And such was the ruling of the court of chancery in England, in *Sparks v. The Liverpool Water-Works Company* (13 Ves. 428). When a penalty or forfeiture is imposed by statute upon the doing or omission of a certain act, courts of equity will not interfere to mitigate the penalty or forfeiture incurred, for it would be in contravention of the direct expression of the legislative will. (Story Eq. Juris., section 1326; 1 Strange 447.) I can not see how this can upon principle be regarded as a mortgage. On the contrary, it has, I think, more of the

properties of a conditional sale, when the absolute title does not pass until payment in full.

Where a party subscribes for stock he takes it upon, and subject to, the condition imposed by statute—that the corporation may, if he omits to pay the installments as they are called for and become due, forfeit the stock and all previous payments. It is then left optional with the corporation whether they will prosecute on the subscription, or forfeit the stock and previous payments. The corporation may doubtless take whichever remedy they elect. But if they elect to forfeit and take back their stock, it seems to me they should not be permitted also to sue and collect the price agreed to be paid, or any part thereof. In that case they take back the whole consideration for the subscriber's promise, with the right to retain whatever may have been paid. It would, after that, be inequitable and unjust to permit them to retain the stock and still prosecute. And it can make no difference that the installments for which the suit is brought became due before the forfeiture was declared. The statute simply authorizes a forfeiture of the stock and all previous payments *made* thereon; but does not declare that the party shall also forfeit the amount of payments which may have become due and remain unpaid. \* \* \*

I think, as I have before stated, that this case is more analogous to a contract for the purchase and sale of property, where the vendor reserves the right, on default of payment at the time stipulated, to rescind the sale or forfeit the contract and previous payments. Suppose a person agrees to sell personal property; one-third of the purchase-money is paid down, and the purchaser agrees to pay the remainder by installments, and if he fails to make either of the payments at the time stipulated, that he will forfeit the property purchased and all previous payments thereon; and upon such default the vendor repossesses himself of the property and takes advantage of the forfeiture. It could hardly be pretended that he could still maintain an action for the price agreed to be paid. I do not see how such a case can be distinguished in principle from the one under consideration. I think the principles decided in *Winter v. Livingston* (13 John. 54) are equally applicable to this case.

*Reversed.*

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Sec. 518. Same. (d) Calls, how made; forfeiture.

BUDD v. MULTNOMAH STREET RAILWAY COMPANY ET AL.<sup>1</sup>

1887. IN THE SUPREME COURT OF OREGON. 15 Ore. 413-420,  
15 Pac. 659, 3 Am. St. Rep. 169.

[Appeal from circuit court. Upon a trial which was had before the court without a jury the following facts were found:]

(1) That the defendant railway company was organized in 1882,

<sup>1</sup>Statement abridged. Part of opinion omitted.

and that D. E. Budd thereafter subscribed for one hundred shares of the capital stock of said corporation, of the nominal par value of \$10,000.

(2) That E. J. Jeffrey, W. A. Scoggin, and D. E. Budd were duly elected directors of said corporation, and duly qualified as such directors.

(3) That at a meeting of the board of directors held on the fourth day of April, 1883, all were present, and it was then and there voted—Jeffrey and Scoggin, yes, and Budd, no—that an assessment of one hundred per centum be levied on all the stock of the corporation, said assessment to be paid by the twenty-fifth of April, 1883.

(4) That on the fifteenth day of April, 1883, a proper written notice, duly issued, was served on Budd, calling a meeting of said corporation, to be held on the twenty-sixth day of April, 1883, for the purpose of disposing of Budd's stock for delinquent assessment.

(5) That on that day a meeting of said directors was held, at which Jeffrey and Scoggin alone were present. It was voted by resolution, and ordered, that "whereas, D. E. Budd has failed to pay any part of the one hundred shares of the capital stock held by him, according to the resolutions of the fourth day of April, 1883, that his assessment is declared delinquent, and that the secretary be directed to sell said one hundred shares of stock, or so much as shall be necessary to satisfy such assessment, after giving thirty days' notice as required by law.

(6) That notice of the sale of said stock was duly published, and on the thirteenth day of May, 1883, said stock of D. E. Budd was offered for sale and was purchased by A. N. and E. A. King, who were the highest bidders for the same, for the sum of \$10,200, of which amount \$10,000 was applied in payment of the subscription and assessment of said Budd.

(7) That the value of said stock, over and above such assessment, was \$200.

(8) That after said sale said stock was transferred on the books of said corporation to the names of A. N. and E. A. King, and said D. E. Budd was no longer recognized by said board of directors of said corporation as a stockholder therein.

The court found that the plaintiff is entitled to recover from the defendants the sum of \$200 and costs.

STRAHAN, J. \* \* \* On this appeal several questions of law have been discussed, which we will now consider.

1. *Assessment of stock.* It is claimed that the "call" or assessment of 100 per cent. on the stock of the defendant corporation was unlawful and unauthorized, for the reason that the resolution adopted by the directors does not show that it was made for any corporate purpose; nor does it show that any demand of the business of the company required that the subscriptions should be paid. This call appears to have been made by the board of directors of the defendant corporation, at which all were present, and there can be no question but what they had the power to make it. If the statute were

entirely silent as to who should exercise the corporate power of making calls on stock, that power would devolve upon the directors. Cook Stock & S., section 109. But the statute contains ample provisions covering this subject. Section 3225, Hill's Code, provides: " \* \* \* From the first meeting of the directors, the powers vested in the corporation are exercised by them, or by their officers or agents, under their direction, except as otherwise provided in this chapter." It is not provided in said chapter that this particular power is vested elsewhere; therefore there can be no question but what it is one of the "powers" which is to be exercised by the directors. And such, it is believed, is the effect of the intimation of this court in *Willamette F. Co. v. Stannus*, 4 Ore. 261; nor is there anything in the other objections taken as to the form of the call. All that is really necessary is that there should be some act or resolution which evinces or shows a clear official intent to render due and payable a part of all the unpaid subscription. Cook Stock & S., section 115. So, also, the necessity of the call is not open to question by the stockholders. The determination of that question is for the board of directors. *Insurance Co. v. Floyd*, 74 Mo. 286; *Judah v. Insurance Co.*, 4 Ind. 333.

2. *Sale for non-payment of assessment.* Counsel for the appellant have argued that the proceedings which were taken by the defendant corporation, upon the failure of Budd to pay the call upon his shares of stock, were entirely irregular and unauthorized by law, and in this we are inclined to think they are correct. A corporation has no inherent power to forfeit or sell the shares of stock owned by delinquent stockholders. That is not a common-law remedy, and can only be exercised when it is expressly conferred by some statute. *Westcott v. Mining Co.*, 23 Mich. 145; Cook Stock & S., section 123. But it is claimed, on the other hand, that the statute has conferred the power exercised in this case, and counsel cite section 3221, subd. 6, Hill's Code. That section contains a particular enumeration of the powers conferred on all corporations organized under said act. By subdivision 6 they are empowered "to make by-laws not inconsistent with any existing law for the sale of any portion of its stock for delinquent or unpaid assessments due thereon, which sale may be made without judgment or execution; provided, that no such sale shall be made without thirty days' notice of time and place of sale, in some newspaper in circulation in the neighborhood of such company, for the transfer of its stock, for the management of its property, and for the general regulation of its affairs." This section confers the power, but it also prescribes the manner in which it shall be exercised. It must be by a "by-law not inconsistent with any existing law." In such a case, if the corporation determines to proceed by a sale of the stock for unpaid assessments, instead of by action to recover the money, it must have such a by-law as the statute prescribes, and compliance with such by-laws must be made to affirmatively appear. But it is claimed that the corporation defendant enacted a by-law for this particular case, and that the same appears



in finding number 5. That resolution is in no sense a by-law. It is directed especially against the interests of a single stockholder. How many others may be delinquent does not appear; possibly none in this particular instance.

But that does not affect the principle. If a majority of a board of directors of a private corporation may in any case pass such a resolution, and enforce it, they may do it in every case. The majority need not enforce the payment of calls, only in particular instances, to be designated by resolution.

As was said in *People v. Throop*, 12 Wend. 183: "The resolution entered by the directors is not entitled to the name of a 'by-law;' it is a mere direction to the officers to exclude a director of the bank from the enjoyment of his rights. It is aimed at a single individual, not a general regulation affecting the directors at large or the stockholders." I think that any by-law enacted under this section of the code, to be reasonable, ought to be general; that is, it ought to affect every delinquent subscriber, and all delinquent stock, alike, and it ought not to be directed against the stock or interests of a particular stockholder. These are essential requisites to a valid by-law. \* \* \*

The sale of the plaintiff's stock by virtue of the resolution set out in the fifth finding was clearly illegal and without authority.

3. *The measure of damages* remains to be considered. The appellant contends that, if the sale was illegal, he is entitled to recover in this form of action the full amount bid for the stock, without any regard whatever to the fact that he had paid nothing for it. In this class of cases the authorities do not seem quite uniform as to the proper measure of damages in case of wrongful conversion. Perhaps the better rule is, the value of the stock at the time of the conversion, or a reasonable time thereafter. *Cook Stock & S.*, section 581. But this general rule is subject to exceptions. \* \* \* In this case these shares were incumbered by an assessment equal to their par value; that is, the purchase-price of those shares for which the plaintiff was indebted to the defendant corporation. That sum must, in any event, be paid to the defendant if the shares would bring it upon the market. The findings show that they did bring that sum, and \$200 more, and that of the proceeds of the sale \$10,000 were applied in satisfaction of plaintiff's debt to the defendant corporation. What effect these proceedings had upon the plaintiff's right to the stock in question we can not now consider, because the question is not involved here. All that we now decide is that, under these findings, the sale of the plaintiff's stock was irregular and unauthorized, and that the court below did not err as to the measure of damages under the peculiar facts of this case.

Thayer, J., concurred.

*Note.* See note, 93 Am. St. R. 349. As to limitation of actions upon subscriptions, see, 1899, *Crofoot v. Thatcher*, 19 Utah 212, 75 Am. St. Rep. 725; 1900, *McCoy v. World's Columbian Exposition*, 186 Ill. 356, 78 Am. St. R. 288.

Sec. 519. Same. (e) Notice of calls.

HEASTON v. THE CINCINNATI AND FORT WAYNE RAILROAD  
COMPANY.<sup>1</sup>

1861. IN THE SUPREME COURT OF INDIANA. 16 Ind. Rep. 275-283.

[Suit by the company on an alleged subscription to the capital stock to the amount of \$1,500.]

PERKINS, J. \* \* \* The board of directors of the company, on June 21, 1853, passed and entered on its records the following resolution:

“*Resolved*, That the stockholders in the Cincinnati and Fort Wayne Railroad Company are hereby required to pay an installment of ten per cent. every thirty days, on all cash subscriptions, until the whole subscriptions are paid; and that due notice thereof be given, signed by the president and secretary.” It was offered in evidence on the trial, and objected to by the appellant for the following reasons, stated at the time:

1. That it was too vague, indefinite and uncertain to bind the defendant.

2. That it did not fix a time when payment of the installments of stock should commence, nor did it fix a definite time when any installment should be paid.

3. That it required the installments of stock to be paid in installments of ten per cent. every *thirty days*.

The court overruled the objections and let the resolution be read to the jury. We think the resolution was admissible, to show a call for payment of an installment in thirty days from date, and every thirty days afterward. The appellee claims to be incorporated under the general railroad law of May 11, 1852, the eighth section of which, 1 R. S. 412, provides that the directors may call in and demand from the stockholders any sums of money by them subscribed, in such payments or installments as the directors shall deem proper, under penalty of forfeiture of the stock subscribed, if payment be not made by the stockholder “within thirty days after personal demand, or notice requiring such payment, shall have been made in each county through which such road shall be laid out, in which a newspaper shall be published: *Provided*, that subscriptions shall not be required to be paid, except in equal installments of not more than ten per cent. a month.”

It is contended that the word month, here, must be taken to mean calendar month, under the rule prescribed by the code, 2 R. S. 339 (Ind. Dig. 748), which is that the word month shall mean calendar month, unless otherwise expressed. We think it is sufficiently expressed otherwise in the above cited section of the railroad law; the word month, in the proviso, is used to express the same time as the words thirty days, in the body of the section.

<sup>1</sup> Only part of opinion relating to the one point given.

Where the charter requires notice as a condition precedent to suits for installments of stock, and there is no waiver of the condition, notice, as required by the charter, must be given. Ind. Dig., sections 73, 74, 75, page 321. The general railroad law above quoted does require notice, or a personal demand, thirty days before a proceeding to forfeit the stock, but not before suit to recover installments. *Smith v. Indiana, etc., Company*, 12 Ind. 61; *Johnson v. The Crawfordsville, etc., Company*, 11 Ind. 280. The subscribers must take notice of the acts of the directors as to calls.

To constitute legal notice under the charter, one and the same notice, fixing the same time for payment, must have been published in a newspaper in each of the counties, in which one was published, through which the line of the road extended.

See note, 93 Am. St. R. 349.

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Sec. 520. Same. (f) Calls must operate equally.

THE GREAT WESTERN TELEGRAPH COMPANY, RESPONDENT, v.  
BURNHAM ET AL., APPELLANTS.<sup>1</sup>

1891. IN THE SUPREME COURT OF WISCONSIN. 79 Wis. Rep.  
47-53.

[Action brought by the telegraph company to collect a call of 35 per cent. upon stock subscriptions made and unpaid by Burnham. This call was ordered by an Illinois court, which was then in control of the company through a receiver appointed in a suit by the corporate creditors. The collection was resisted upon the ground, among others, that it operated unequally upon shareholders, and was therefore invalid.]

COLE, C. J. \* \* \* We will further assume that the Illinois court of equity in the suit before it, having also before it all the evidence as to the organization of the corporation, the validity of the stock subscriptions, and the liabilities of the corporation, could decree or make a call on the unpaid subscriptions to the stock, in the same manner and with like effect as though the directors of the corporation themselves had ordered the assessment, as they were authorized to do by the contract of subscription. But we fully agree with the appellants' counsel that any call or assessment made upon the shares must be uniform, and in ratable amounts, and that any call or assessment which requires some shareholders to pay a higher rate than other shareholders is unjust, and should not be enforced. We have referred to the averment of the complaint which states that some of the stockholders have paid \$10, or forty per cent., on each share of stock held by them, *while many of the stockholders have never paid more than fifty cents, or two per cent., on a share.* It requires no argument to

<sup>1</sup> Statement abridged; only the part of opinion relating to the one point is given.

show that such a call or assessment on the stock is grossly unequal and unjust. We think Mr. Morawetz states the correct rule on this subject in the following language: "Justice between the shareholders of a corporation requires that all the shareholders should contribute in respect to their shares at the same time, and in ratable amounts. A call requiring some shareholders to pay in more than others would, therefore, be invalid. But, if some shareholders have already contributed more than others, it would be not only the right but the duty of the directors to make calls upon the other shareholders in such amounts as to equalize the contributions of all." Mor. Priv. Corp. (2d ed.), section 154. See, also, *Pike v. B. & C. S. L. R. Co.*, 68 Me. 445. Cook on Stock and Stockholders (2d. ed., section 114) says: "A call \* \* \* must be made on all alike, or it will be void. The courts will not allow the directors of a company so to proceed as to require some stockholders to pay calls, and not to require others to do the same." And this accords with common sense, and all notions of equity and fairness.

Order of circuit court overruling demurrer to complaint *reversed*.

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**Sec. 521. Same. (g) Calls must be uniform.**

**RUSE v. BROMBERG.<sup>1</sup>**

1889. IN THE SUPREME COURT OF ALABAMA. 88 Ala. Rep. 619-630.

[Bill by Bromberg as assignee of all the property of two insolvent corporations against Ruse and his wife and their grantees to set aside, as fraudulent, certain conveyances alleged to have been made by them without valuable consideration, when Ruse was largely indebted to the said corporations for unpaid sums due on stock subscriptions which were evidenced by notes given therefor and on other accounts; the defendants below answered denying the right of the company to attack these proceedings until a certain indebtedness is established against them, which is not and can not be done except by regular proceedings against the stockholders, so that the court may call for such an assessment as may be necessary to settle all outstanding claims. After the cause had been submitted, they asked to amend this answer, so as to deny any right to attack the proceedings, until a fixed indebtedness is established against them or Ruse, by a judgment in a common-law court, and upon which execution had been returned "no property found;" this was denied and decreed for complainants. The ruling and decree are the errors assigned.]

CLOPTON, J. \* \* \* The amendment further controverts the right of complainant to proceed to subject property alienated by the

<sup>1</sup>Statement abridged. Arguments omitted. Only the part of opinion relating to the one point is given.

debtor to the payment of notes given for the unpaid capital stock subscribed for, or purchased by him, until by proper proceedings against all the shareholders the amount of the outstanding liabilities of the corporation is ascertained, the *pro rata* proportion of each assessed, and a call therefor made. When the liability is upon a subscription to the capital stock, and the charter or contract of subscription provides that the shares shall be paid in as required by the board of directors, the general rule is that the stockholder's liability does not mature, and he can not be sued by the company until a call is made. If the charter and contract of subscription are silent as to the time of payment, a call or assessment is an implied condition precedent to a matured liability. The rule is otherwise when, by the provisions of the charter or of the contract, the subscription is payable at specified times and in specified amounts. In such case, the liability matures, and the subscriber is bound to pay, in all events, on the day stated; a call is not requisite. 1 Morawetz on Corp., section 144; Cook on Stock., section 106. The grantor in two of the conveyances attacked gave notes for the unpaid capital stock of the companies, payable on demand. Without regard to a call or assessment upon all the shareholders, the company could have instituted, at any time after the dates of the respective notes, a suit at law upon the notes, or have filed a bill to subject to their payment property fraudulently conveyed by the debtor; such suit being a sufficient demand. Complainant, as assignee appointed by the board of directors, is clothed with all the rights and powers of the board essential to make the corporate assets available, and for this purpose may maintain any suit, at law or in equity, which the corporation could have brought. Chamberlain v. Bromberg, 83 Ala. 576; Wooldridge v. Holmes, 78 Ala. 568.

The disallowance of the proposed amendment does not affect the propriety of the decree, so far as the questions raised thereby are concerned.

*Reversed* on other grounds.

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Sec. 522. Same. (h) Calls must be made by legal directors.

MOSES v. TOMPKINS.<sup>1</sup>

1887. IN THE SUPREME COURT OF ALABAMA. 84 Ala. Rep. 613-623.

[Bills by shareholders (appellees) to enjoin appellants, who claim to be directors of a street railway company, from selling the stock of complainants for payments of assessments and calls thereon, upon the ground that the directors who had made the calls were not legally

<sup>1</sup> Statement abridged. Argument and part of opinion upon other points omitted.

elected. The statute provided that only shareholders owning ten shares of stock should be directors; three of the five directors sold out, and so were disqualified; the other two directors, without authority, elected three other shareholders directors, and the board as thus constituted made the calls, and were about to forfeit the stock for non-payment.]

CLOPTON, J. \* \* \* In order that an assessment and call for the payment of subscriptions to the capital stock of a corporation may be legal and enforceable, it must, ordinarily, be made by the corporate authorities, in whom the power is vested by the charter or by-laws, or by the general laws. In *Garden G. U. Q. Min. Co. v. McLister*, 1 L. R. App. Cas. 39, a bill was filed to declare invalid a forfeiture of stock for the non-payment of calls made by directors alleged to have been illegally elected. The question of the validity of the forfeiture ultimately depended on the validity of the election of the persons who, assuming to be directors, declared complainants' shares forfeited for non-payment of a call made by them. The bill was sustained; the declaration of the forfeiture declared invalid; and it was held that there must be properly appointed directors to make a call, and to declare a forfeiture of shares for non-payment. It has also been held in other cases, that the illegality of the election of the persons who, as directors, make a call, may be set up in resistance to a suit for its recovery. *People's Mut. Ins. Co. v. Wescott*, 14 Gray 440. To prevent irreparable mischief, multiplicity of suits, the destruction and impairment of the pecuniary rights of the stockholders, equity will interfere, at the instance of a stockholder, and restrain the sale of his stock for the payment of a call made by illegally elected or appointed directors. The validity of the election of defendants as directors arises collaterally and incidentally, and the duty to inquire into and decide the question is necessarily involved. \* \* \*

It is further insisted, that, though the persons appointed to fill the vacancies were not legally elected, they are actually holding and exercising the powers and functions of the office, and are directors *de facto*; and inasmuch as the power to make assessments and calls is vested in the board of directors, a call made by directors *de facto* can not be collaterally called in question by a stockholder. To constitute an officer *de facto*, there must be a color of election or appointment, or an exercise of the functions of the office under such circumstances and for such length of time without interference, as to justify the presumption of a due election or appointment. *Cary v. State*, 76 Ala. 78. The mere exercise of the functions of the office is in itself insufficient. The bills allege only two official acts of the defendants as directors, and it may well be doubted whether the allegations make a *prima facie* case of directors *de facto*. The facts set up in the answers, on which this claim is rested by the defendants, can not be considered on a motion to dissolve the temporary injunction. But passing this question, we shall proceed to consider the right of a stockholder to set up the illegality of the election, though the persons may have become directors *de facto*, in resistance to an assessment



debtor to the payment of notes given for the unpaid capital stock subscribed for, or purchased by him, until by proper proceedings against all the shareholders the amount of the outstanding liabilities of the corporation is ascertained, the *pro rata* proportion of each assessed, and a call therefor made. When the liability is upon a subscription to the capital stock, and the charter or contract of subscription provides that the shares shall be paid in as required by the board of directors, the general rule is that the stockholder's liability does not mature, and he can not be sued by the company until a call is made. If the charter and contract of subscription are silent as to the time of payment, a call or assessment is an implied condition precedent to a matured liability. The rule is otherwise when, by the provisions of the charter or of the contract, the subscription is payable at specified times and in specified amounts. In such case, the liability matures, and the subscriber is bound to pay, in all events, on the day stated; a call is not requisite. 1 Morawetz on Corp., section 144; Cook on Stock., section 106. The grantor in two of the conveyances attacked gave notes for the unpaid capital stock of the companies, payable on demand. Without regard to a call or assessment upon all the shareholders, the company could have instituted, at any time after the dates of the respective notes, a suit at law upon the notes, or have filed a bill to subject to their payment property fraudulently conveyed by the debtor; such suit being a sufficient demand. Complainant, as assignee appointed by the board of directors, is clothed with all the rights and powers of the board essential to make the corporate assets available, and for this purpose may maintain any suit, at law or in equity, which the corporation could have brought. Chamberlain v. Bromberg, 83 Ala. 576; Wooldridge v. Holmes, 78 Ala. 568.

The disallowance of the proposed amendment does not affect the propriety of the decree, so far as the questions raised thereby are concerned.

*Reversed* on other grounds.

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Sec. 522. Same. (h) Calls must be made by legal directors.

MOSES v. TOMPKINS.<sup>1</sup>

1887. IN THE SUPREME COURT OF ALABAMA. 84 Ala. Rep. 613-623.

[Bills by shareholders (appellees) to enjoin appellants, who claim to be directors of a street railway company, from selling the stock of complainants for payments of assessments and calls thereon, upon the ground that the directors who had made the calls were not legally

<sup>1</sup> Statement abridged. Argument and part of opinion upon other points omitted.

elected. The statute provided that only shareholders owning ten shares of stock should be directors; three of the five directors sold out, and so were disqualified; the other two directors, without authority, elected three other shareholders directors, and the board as thus constituted made the calls, and were about to forfeit the stock for non-payment.]

CLOPTON, J. \* \* \* In order that an assessment and call for the payment of subscriptions to the capital stock of a corporation may be legal and enforcible, it must, ordinarily, be made by the corporate authorities, in whom the power is vested by the charter or by-laws, or by the general laws. In *Garden G. U. Q. Min. Co. v. McLister*, 1 L. R. App. Cas. 39, a bill was filed to declare invalid a forfeiture of stock for the non-payment of calls made by directors alleged to have been illegally elected. The question of the validity of the forfeiture ultimately depended on the validity of the election of the persons who, assuming to be directors, declared complainants' shares forfeited for non-payment of a call made by them. The bill was sustained; the declaration of the forfeiture declared invalid; and it was held that there must be properly appointed directors to make a call, and to declare a forfeiture of shares for non-payment. It has also been held in other cases, that the illegality of the election of the persons who, as directors, make a call, may be set up in resistance to a suit for its recovery. *People's Mut. Ins. Co. v. Wescott*, 14 Gray 440. To prevent irreparable mischief, multiplicity of suits, the destruction and impairment of the pecuniary rights of the stockholders, equity will interfere, at the instance of a stockholder, and restrain the sale of his stock for the payment of a call made by illegally elected or appointed directors. The validity of the election of defendants as directors arises collaterally and incidentally, and the duty to inquire into and decide the question is necessarily involved. \* \* \*

It is further insisted, that, though the persons appointed to fill the vacancies were not legally elected, they are actually holding and exercising the powers and functions of the office, and are directors *de facto*; and inasmuch as the power to make assessments and calls is vested in the board of directors, a call made by directors *de facto* can not be collaterally called in question by a stockholder. To constitute an officer *de facto*, there must be a color of election or appointment, or an exercise of the functions of the office under such circumstances and for such length of time without interference, as to justify the presumption of a due election or appointment. *Cary v. State*, 76 Ala. 78. The mere exercise of the functions of the office is in itself insufficient. The bills allege only two official acts of the defendants as directors, and it may well be doubted whether the allegations make a *prima facie* case of directors *de facto*. The facts set up in the answers, on which this claim is rested by the defendants, can not be considered on a motion to dissolve the temporary injunction. But passing this question, we shall proceed to consider the right of a stockholder to set up the illegality of the election, though the persons may have become directors *de facto*, in resistance to an assessment

and call on subscriptions to the capital stock. We are cognizant that some courts of the highest authority have held that the power of persons to act in behalf of the corporation, who have become directors *de facto*, can not be collaterally questioned by a stockholder, without a judgment of ouster against them in a direct proceeding for that purpose. An analysis of the cases would show, we think, that in a majority of them the election was not illegal and void, but irregular and voidable, because of ineligibility, or other cause, or if originally illegal, that the shareholder assailing its validity had affirmatively acquiesced in their acts as directors. The doctrine of the validity of the acts of officers *de facto* rests on public policy and justice. The official dealings of directors *de facto* with third persons are sustained as rightful and valid, on the ground of continuous acquiescence by the corporation, and suffering them to hold themselves out as having such authority, thereby inducing others to deal with them in such capacity.

The theory of the doctrine of officers *de facto*, and the principles sustaining the validity of their official acts, are that, though wrongfully in office, yet exercising power and functions appertaining to such office, justice and necessity require, for the protection and preservation of the rights and interests of third persons, that their acts, within the scope of official authority and duty, shall be sustained. The stockholders are not third persons in their relation to the corporation. If persons undertake to exercise the functions and discharge the duties of directors in opposition to the will of a majority of the stockholders, they are mere usurpers, and their acts can not be deemed valid, when invoked for their own protection. Otherwise, the wrongful assumption of official authority and its exercise would operate to constitute the usurpers, as *between themselves and the corporation and shareholders*, a board invested with the power to transact its business and administer its affairs. In such case, the necessity and justice of the rule as to the validity of the acts of directors *de facto* do not exist, and the rule itself is inapplicable. The acts of officers *de facto* are only valid when third persons have rights and interests to be protected. By the terms of their contract an assessment or call, made by directors duly appointed, is essential to create a liability on the stockholders. The validity of the acts of directors *de facto* and their authority may be called in question by a stockholder whenever such acts are destructive or affect his property rights, or impose a liability on him as such, and the rights of third persons do not intervene. *Thorington v. Gould*, 59 Ala. 461; *People's Mut. Ins. Co. v. Wescott*, 14 Gray 440.

*Injunction allowed.*

*Note.* See, 1899, *New England Fire Insurance Co. v. Haynes*, 71 Vt. 306, 76 Am. St. Rep. 771; 1902, *Gettysburg Nat'l Bank v. Brown*, 95 Md. 367, 93 Am. St. R. 339, 52 Atl. 975. *Note*, 93 Am. St. R. 349.

Sec. 523. 4. Assessments beyond full payment of amount subscribed.

ENTERPRISE DITCH CO. ET AL. v. MOFFITT ET AL.<sup>1</sup>

1899. IN THE SUPREME COURT OF NEBRASKA. 58 Neb. 642, 76 Am. St. 122, 45 L. R. A. 647, 79 N. W. Rep. 560-561.

[Suit by Moffitt and others to enjoin the sale of their shares of fully paid stock in the ditch company, by that company, because of certain assessments made upon the stock and not paid. The corporation was organized in 1889 to distribute water for irrigating purposes; the trustees were authorized to make such by-laws "as they shall deem proper and expedient for the management" of the corporate business. It was also provided in the by-laws that the board should at its first quarterly meeting make an estimate of the total cost of maintenance, and "levy an assessment for such an amount, subject to the call of the board of directors, from time to time, as the same shall be needed," and provided for sale after certain notices, for non-payment. In January, 1894, a special levy of \$6.50 per share, and in November, 1894, an additional levy of \$1.50 per share, were made for the purpose of enlarging the canal; in April, 1895, another levy of \$4.50 per share for that year was made. These assessments were not paid by the plaintiffs, and the company proceeded to advertise the delinquent shares for sale. Shortly before the last assessment, a law was passed to the effect that such a company as the Enterprise Ditch Company should be termed a mutual irrigation company, and any by-laws made either before or after this act, and not inconsistent with it, shall be lawful, and providing that such company could assess the shares of stock for the purpose of defraying the necessary running expenses, and making such an assessment a lien on the stock, and if not paid in sixty days the stock should be sold to pay the assessment. Injunction was allowed by the court below.]

HARRISON, C. J. \* \* \* (As to the condition before the law of 1895.) There was no statutory authority to assess stock of which the amount had been fully paid, neither did the articles of incorporation confer any express power so to do. In the absence of authorization by either, the directors could not enact a by-law by which provision was made for such assessments, and especially not to be enforced by a sale or practical forfeiture of stock. *Association v. Connell*, 55 Neb. 396, 75 N. W. Rep. 837; *De Laine Co. v. Mason*, 5 R. I. 463; 2 *Beach Priv. Corp.*, section 590; 1 *Cook Stock, Stockh. & Corp. Law*, sections 241, 242; 1 *Thomp. Corp.*, sections 1037, 1038; *Rosenback v. Bank*, 53 Barb. 495; *In re Long Island R. Co.*, 19 Wend. 37; *State v. Morristown Fire Assn.*, 23 N. J. Law 195; *Williams v. Lowe*, 4 Neb. 382.

<sup>1</sup> Statement much abridged, part of opinion omitted.

(As to effect of law of 1895.) The paid share or shares of stock were the personal property of any individual owner, and a contract which embodied the articles of incorporation and the pertinent laws of the state existed, to which the shareholder was a party. Without a discussion or notice of some other branches of the argument and subject, it must be said that the legislature could not so change these accrued, contractual, and property rights as to allow an assessment against the paid-up stock, and its forfeiture or sale for the non-payment. This would involve too violent an invasion of property and contract rights. 1 Cook Stock, Stockh. & Corp. Law, section 492; Manufacturing Co. v. Sheldon, 44 Neb. 279, 62 N. W. Rep. 480; City of Detroit v. Detroit and Howell Plank Road Co. (Mich.), 5 N. W. Rep. 279; 1 Beach Priv. Corp., sections 40, 41; 1 Cook Stock, Stockh. & Corp. Law, section 50.

It follows that the decree will be *affirmed*.

*Note.* See note, 76 Am. St. Rep. 126; 1898, Duluth Club v. Macdonald, 74 Minn. 254, 73 Am. St. Rep. 344.

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#### Sec. 524. 5. Right to reserve a lien upon shares.

See Child v. Hudson's Bay Co., 2 P. Wms. 207, *supra*, p. 1161; Brinkerhoff-Farris Trust, etc., Co. v. Home Lumber Co., 118 Mo. 447, *supra*, p. 1162.

*Note.* 1899, Stafford v. Produce, etc., Banking Co., 61 Ohio St. 160, 76 Am. St. Rep. 371.

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#### Sec. 525. 6. Right to regulate transfers.

See The Victor G. Bloede Co. v. Bloede, 84 Md. 129, 57 Am. St. Rep. 373, *supra*, p. 1159; and *infra*, §§ 558-9.

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#### Sec. 526. 7. Right to carry on the corporate enterprise through its proper representatives.

See Metropolitan Elevated R. Co. v. Manhattan R. Co., 11 Daly 373, *supra*, p. 694; Smith v. Hurd, 12 Metc. (Mass.) 371, *infra*, p. 1706.

*Note.* See, 1899, Colorado Springs Co. v. Am. Pub. Co., 97 Fed. Rep. 843.

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#### Sec. 527. 8. Right to accept amendments.

See Buffalo & N. Y. C. R. Co. v. Dudley, 14 N. Y. 336, *supra*, p. 1461; Durfee v. Old Colony, etc., R. Co., 5 Allen (Mass.) 230, *supra*, p. 1462; Zabriskie v. Hackensack, etc., R., 18 N. J. Eq. 178, *supra*, p. 1466.

Sec. 528. 9. Right to dissolve itself.

See *The Merchants' Bank v. Heard*, 37 Ga. 401, *supra*, p. 877; *Merchants' and Planters' Line v. Waganer*, 71 Ala. 581, *supra*, p. 880; *Slee v. Bloom*, 19 Johns. 456, *supra*, p. 881.

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ARTICLE II. RIGHTS OF SHAREHOLDERS.

Sec. 529. 1. Who are shareholders.

(a) Certificate; subscription; payment.

PACIFIC NATIONAL BANK v. EATON.<sup>1</sup>

1891. IN THE SUPREME COURT OF THE UNITED STATES. 141 U. S. Rep. 227-234.

[Action to recover from the bank an amount paid in as a subscription to an increase of its stock. The bank was organized with a capital stock of \$500,000, and on September 13, 1881, it was resolved to increase the stock to \$1,000,000, each shareholder to have the right to take, at par, his *pro rata* share. Miss Eaton then owned forty shares (equal to \$4,000), and on September 28 took and paid for forty shares of the new stock. All the shareholders did not avail themselves of their privilege, and only \$461,300 of the \$500,000 were taken and paid in. At request of directors, and with sanction of a large majority of shareholders, and the approval of the comptroller of the currency, the increase was limited to the amount taken, and certificates were prepared and delivered to such as called for them; Miss Eaton never called for hers, though it was made out, and she was registered as an owner without her knowledge. At a meeting of shareholders, and under lawful authority, it was voted, in January, 1882, to assess the shareholders 100 per cent. Miss Eaton, on the day of, but before, the meeting, claiming she had never consented to the reduction of the increase of stock from \$500,000 to \$461,300, demanded repayment of the sum of \$4,000. This being refused, she sued, and got judgment in the supreme judicial court of Massachusetts. The bank sued out this writ of error.]

MR. JUSTICE BRADLEY. \* \* \* The court also assumed that the filling of the whole \$500,000 of stock was a condition on which the obligation of the subscribers to the new stock to take the same depended. The latter point was fully considered by us in the case of *Aspinwall v. Butler*, 133 U. S. 595, and we held that the filling of the said \$500,000 of additional stock was not a condition of the liability of the subscribers to the new stock, but that the association always retained the power of reducing the amount of stock, with the approval of the comptroller of the currency. It is unnecessary for us

<sup>1</sup> Statement abridged, and only part of opinion given. Arguments omitted.



to discuss that question again. The defendant in error was just as much bound by her subscription to the new stock as if the whole \$500,000 had been subscribed and paid in. The only question to be considered, therefore, is whether the fact that the defendant in error did not call for and take her certificate of stock made any difference as to her status as a stockholder. We can not see how it could make the slightest difference. Her actually going or sending to the bank and electing to take her share of the new stock, and paying for it in cash, and receiving a receipt for the same in the form above set forth, are acts which are fully equivalent to a subscription to the stock in writing, and the payment of the money therefor. She then became a stockholder. She was properly entered as such on the stock book of the company, and her certificate of stock was made out ready for her when she should call for it. It was her certificate. She could have compelled its delivery had it been refused. Whether she called for it or not was a matter of no consequence whatever in reference to her rights and duties.

The case is not like that of a deed for lands, which has no force, and is not a deed, and passes no estate, until it is delivered. In that case everything depends on the delivery. But with capital stock it is different. Without express regulation to the contrary, a person becomes a stockholder by subscribing for stock, paying the amount to the company or its proper officer, and being entered on the stock book as a stockholder. He may take out a certificate or not, as he sees fit. Millions of dollars of capital stock are held without any certificate; or, if certificates are made out, without there ever being delivered. A certificate is authentic evidence of title to stock; but it is not the stock itself, nor is it necessary to the existence of the stock. It certifies to a fact which exists independently of itself. And an actual subscription is not necessary. There may be a virtual subscription, deducible from the acts and conduct of the party.

*Reversed.*

Compare, 1902, Gettysburg Nat'l Bk. v. Brown, 95 Md. 367, 93 Am. St. R. 339, note 349.

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**Sec. 530. Same. (b) Certificate and payment, in case of increase of stock.**

**THE BALTIMORE CITY PASSENGER RAILWAY COMPANY v. JOHN A. HAMBLETON.<sup>1</sup>**

1893. IN THE COURT OF APPEALS OF MARYLAND. 77 Md. Rep. 341-352.

[Bill by Hambleton to compel the railway company to transfer on its books, and issue to him certificates for eighty-five shares of stock. The company had been duly authorized to increase its capital stock, and had done so by doubling it; each shareholder was to have the

<sup>1</sup> Statement abridged. Arguments and part of opinion omitted.

privilege of subscribing *pro rata*, and paying the par value thereof "when the directors shall call for the same." Miss Hollins was the owner of eighty-five shares at that time, and subscribed for eighty-five shares of the new stock and caused her name to be placed in the subscription book. She subsequently died, and her executor sold the original eighty-five shares to Hambleton, who claimed that by reason of this purchase he became the owner of the eighty five-shares of new stock subscribed for by Miss Hollins, and was entitled to have the new shares transferred to him on the books, and a certificate issued to him, subject to the right of the company to demand payment of the par value. The company refused to recognize this claim, and he sued to enforce it, prayed for and obtained decree to that effect. From this decree an appeal was taken.]

McSHERRY, J. \* \* \* It will be observed that the shares in controversy are not part of the original stock of the company; they are some of the new or additional stock, and the distinction between these two classes—between original or formative stock and subscriptions for new stock, which a corporation after its organization has been authorized to issue—is important in its bearing on the decision of the principal question involved in this cause. There is a substantial difference between an increase of capital and a filling up of one both authorized and required. *Curry v. Scott*, 54 Pa. St. 276. When the subscription to formative stock precedes the creation of the body corporate which will ultimately issue the certificates, there is, of necessity, at the time such subscriptions are entered into, no corporation in existence with which a contract could be made. The subscribers, as a consequence, and for the very purpose of effecting an organization, become stockholders by the mere act of subscribing, if there are no conditions precedent prescribed, and they are thereby invested with the privileges and subjected to the liabilities incident to that relation. The subscribers, in the absence of any statutory restrictions, acquire by such a subscription an interest in the body corporate and a right to participate in its organization. They all stand upon the same footing, incurring the risks and hazards of a failure of the enterprise or sharing its profits in proportion to their interests; and to give vitality to the artificial entity they must become stockholders immediately upon becoming subscribers, if no other method be provided in the charter. But the same reasons do not apply, and the same conditions do not obtain, in the case of new or additional stock authorized to be issued by an existing and completely organized corporation. A subscription to such new stock does not necessarily of itself make the subscriber a stockholder, because, generally speaking, it is a mere contract between the subscriber and the corporation. If by a mere subscription for new stock the subscriber becomes a stockholder, he at once becomes clothed with all the rights of a stockholder, and without the payment of a dollar he would be at liberty to vote his stock, and entitled to claim dividends upon it. As between shareholders of the same class there can be no discrimination, and profits set aside for dividends must be evenly divided amongst the

stockholders according to the amount of stock each one owns. *Harrison v. Mexican Railway Co.*, L. R. 19 Eq. Cases 358. Hence the policy of a corporation might be molded or controlled by mere subscribers, who have paid nothing upon their subscriptions, to the prejudice or loss of the full-paid shareholders, whose money, contributed in the beginning, had actually developed the enterprise. Part of the stock would then be full-paid and the rest would be stock upon which nothing had been paid—and yet the latter would possess all the advantages, privileges and incidents which belong to the former, and might be so managed as to render the paid-up stock wholly or partially valueless. Whilst it has been held that stockholders who have partially paid for, but have not been called upon to pay up their stock in full, are entitled, when dividends have been declared, to participate therein equally with shareholders whose stock has been entirely paid for, *Oakbank Oil Co. v. Crum*, L. R. 8 App. Cases 65, still a *mere subscriber* for stock can claim no such right.

To constitute a subscriber for new stock a stockholder, something more than a mere subscription is requisite—*payment* is necessary. The subscription is but the contract; *payment*, when called by the company and when made by the subscriber, constitutes him a shareholder whether a certificate has been issued or not. *Fulgam v. Macon & Brunswick R. Co.*, 44 Ga. 597; *Terwilliger v. G. W. Tel. Co. et al.*, 59 Ill. 249; *Johnson v. Albany & Susq. R. Co.*, 54 N. Y. 416; *Jay Gould v. Town of Oneonta*, 71 N. Y. 298; *Pacific Nat. Bank v. Eaton*, 141 U. S. 227. \* \* \*

(After reviewing cases.) The sale by Miss Hollins' executor of the eighty-five shares of old stock carried with it as an incident the right which the testatrix had previously acquired by virtue of her subscription, to purchase eighty-five shares of the new stock, and the appellee has under the transfer made to him precisely that right and none other. The terms upon which the subscription was made by Miss Hollins are binding upon the appellee as they were upon her. Payment of the par value in money, at the times and in the installments to be named by the directors, must be made before the title will pass. The subscriber binds himself to pay when requested, and the company in turn undertakes upon receiving payment to enter him as a stockholder on its books. Until this is done the contract is executory, and neither the subscriber nor his assignee is a stockholder, and consequently neither is entitled to a certificate of stock or to any other instrument indicating that he is the owner of the shares. The obligation he assumes to pay for the stock enures under section 64, article 23 of the code, to the benefit of creditors of the corporation, but does not give him a beneficial interest in the body corporate as an owner of its stock until the stock has been paid for. \* \* \*

The decree of the court below directed an injunction to issue as prayed, but for the reasons we have given, that decree was erroneous, and must be reversed. And as Mr. Hambleton will not be entitled to any certificate until he becomes a stockholder as to these new shares, none of the relief sought under the bill can be granted, and the bill will, therefore, have to be dismissed.

**Sec. 531. Same. (c)** Shares held as collateral security.

**STATE v. BANK OF NEW ENGLAND ET AL.<sup>1</sup>**

1897. IN THE SUPREME COURT OF MINNESOTA. 70 Minn. Rep. 398-403.

[In a suit by the state to have a receiver of the bank appointed, one Hanson was allowed to intervene on behalf of himself and the other creditors, for the purpose of enforcing the statutory liability of shareholders, J. F. Calhoun being alleged to be one. July 1, 1892, one Blethen, president of the bank, asked a loan of \$4,500 from Calhoun, and offered to give him as security a certificate of stock of the bank of \$5,000 par value. Calhoun made the loan, Blethen executed a note for \$4,500, and on September 14, 1892, delivered a stock certificate, dated July 2, 1892, for \$5,000; this certificate was in fact, part of an authorized increase of the stock of the company, though never subscribed for or known to be such by Calhoun. November 23, 1892, the note was paid, the certificate of stock returned and canceled. The bank suspended payment June 26, 1893, and made an assignment July 6, 1893.]

BUCK, J. \* \* \* Under these facts, the court found, as a conclusion of law, that Calhoun became and was a stockholder, and liable as such, and the only question presented is whether, upon these facts, he was a stockholder within the meaning of the statute.

G. S. 1894, section 2501, in part, reads as follows:

"The stockholders in each bank shall be individually liable in an amount equal to double the amount of stock owned by them for all the debts of such bank, and such individual liability shall continue for one year after any transfer or sale of stock by any stockholder or stockholders."

Within the time fixed by the statute imposing this liability upon stockholders, there were fifty shares of the stock in the defendant bank standing in Calhoun's name upon the books of the bank; and if, during such time, he was the actual owner thereof, he was liable for the debts of the bank, under the terms of the statute above quoted, if the bank was then insolvent. Nor is he relieved from this liability as a stockholder because he held the certificate of stock in question as collateral security for a debt. Thomp. Liab. Stockh., section 223, citing numerous authorities to sustain this position, says:

"The reason why the courts so hold, briefly, is that a man can not become the legal owner of stock, receive dividends, vote at elections, and enjoy all other rights appertaining to the ownership of it, without shouldering the liabilities attaching to such a position. Another good reason is that he will not be suffered to hold himself out to the public as the owner of stock, and afterwards deny that relation. Besides, if creditors were compelled to look beyond the legal title, they could never know against whom to proceed, and it would embarrass them in

<sup>1</sup> Statement abridged. Part of opinion omitted.

the pursuit of their rights to compel them to inquire into equities which might exist between the stockholder and some third person. See, also, Pullman v. Upton, 96 U. S. 328; National Bank v. Case, 99 U. S. 628."

Even if these things were not done by Calhoun, he had the rights appertaining to the ownership of the stock, and the right, as a stockholder, to demand or accept the benefits should impose upon him the duty of shouldering the burdens. That he accepted the stock, and used it, is unquestioned. It is not a question of whether he paid for the stock, and had it issued in his own name, with the intent to become a stockholder in the bank, but whether the liability did not accrue when he permitted himself to be held out to the public as a stockholder, by accepting the stock in his own name, and allowing it so to stand upon the books of the corporation. Parties dealing with corporations have a right to assume that one representing himself to the world as a stockholder in such corporation, by permitting his name to stand on its books as such, must take the responsibilities of the situation.

*Affirmed.*

See also, 1902, Sherwood v. Trust Co., 195 Ill. 112, 88 Am. St. R. 183.

Sec. 532. Same. (d) Corporate books as evidence of membership.

#### CAREY v. WILLIAMS.<sup>1</sup>

1897. IN THE U. S. CIRCUIT COURT OF APPEALS, SECOND CIRCUIT.  
79 Fed. Rep. 906-913.

[Error by plaintiff below to review judgment in favor of defendant, on verdict directed by the court, in a suit to recover assessments against defendant as alleged holder of two hundred and fifty shares of stock in an express company. The plaintiff sought to prove that the defendant was a shareholder "by entries in the books of the company showing the transfer of two hundred and fifty shares of stock from the company to the defendant November 1, 1865, and his payment of two calls thereon for \$1,250 each,—the first November 1, 1865, and the second March 9, 1866." The judge ruled that this and an alleged admission in an affidavit in a certain suit between the company and another party were insufficient to authorize the submission of the issue to the jury. This is the error assigned.]

WALLACE, Circuit Judge. \* \* \* (After holding there was no admission in the affidavit.) We are thus brought to the important question in the case, which is whether the entries contained in the corporate books of the company afforded *prima facie* evidence that the defendant was a stockholder. The relation of corporation and stockholder is a contractual one, and can only be created with the consent,

<sup>1</sup> Statement abridged. Only part of opinion given.

express or implied, of both parties. The assent is evidenced when the name of the stockholder appears as such upon the books of the company; as to the corporation, by its act in placing his name there, and, as to the stockholder, by his knowledge and acquiescence in the act. It is not enough that he appears to be a stockholder upon the books, and when this occurs without his sanction he incurs no liability as such.

It is an elementary rule of the law of evidence that a party can not make evidence in his own favor, of a contract, by his own statements or declarations of its existence or its terms. They are evidence against him, but not for him. Accordingly it has uniformly been held that entries in the books of a copartnership, in the nature of declarations showing who are the persons that compose the firm, are not evidence in behalf of the partners, as against a third person, for the purpose of showing that the latter was a member. There is no reason why a different rule should be applied to the entries in the books or records of a corporation which tend to charge a party with the responsibilities of a stockholder. Corporations are not exempt from the ordinary rules of evidence, and there is no stronger presumption of honesty, or regularity or accuracy as to their books or records than there is in the case of natural persons.

Prior to the case of *Turnbull v. Payson*, 95 U. S. 418, in which Mr. Justice Clifford made an observation to the contrary, there was no respectable authority for the proposition that, without the aid of some statute changing the ordinary rule of evidence, the appearance of the name of a person on the books of a corporation as a stockholder, without other evidence, created a presumption, as against him, of his ownership of the stock. The only reported decision in which it had been so declared was the *nisi prius* case of *Hoagland v. Bell*, 36 Barb. 57. The opinion consisted merely of the statement that the appearance of the defendant's name on the stock-book as a shareholder was *prima facie* evidence that he was so, and the burden was then thrown on him to disprove that he was a stockholder. No reasons were assigned, no authority was cited, and there was no discussion of the question upon principle. It may be that the statute under which the corporation was organized dispensed with the ordinary proof by a provision, which has occasionally been adopted, giving to such an entry upon the books of the corporation the force of evidence. No subsequent decisions by the courts of New York have adopted that decision, and, as will be seen, it is irreconcilable with their later decisions.

*Turnbull v. Payson* was an action to recover an assessment upon a stockholder, and the plaintiff offered to prove that the defendant was a stockholder (1) by the books of the corporation, in which the name of the defendant was entered as the owner of fifty shares; (2) by the stock-book of the company, with a duplicate of the stock certificate issued to the defendant, showing that he was the owner of the same number of shares; (3) by testimony that the certificate was sent to the agents of the company to be delivered to the defendant when he



paid 20 per cent. of the shares, and that he made the required payment; and (4) by a receipt, signed by the defendant, showing that the company paid the defendant a dividend upon his stock. The court decided that the exceptions to the evidence thus offered were not tenable, and Mr. Justice Clifford said:

“Taken as a whole, it is clear that the evidence offered was amply sufficient to warrant the jury in finding that the defendant was a stockholder, as alleged.”

He then made this observation:

“Where the name of an individual appears on the stock-book of a corporation as a stockholder, the *prima facie* presumption is that he is the owner of the stock, in a case where there is nothing to rebut that presumption; and, in an action against him as a stockholder, the burden of proving that he is not a stockholder, or of rebutting that presumption, is cast upon the defendant.”

He cited as authorities for the observation, *Hoagland v. Bell*, *supra*; *Plank Road Co. v. Rice*, 7 Barb. 162; *Turnpike Road v. Van Ness*, 2 Cranch C. C. 451, Fed. Cas. No. 11,986; *Mudgett v. Horrell*, 33 Cal. 25; *Coffin v. Collins*, 17 Me. 440; *Merrill v. Walker*, 24 Me. 237. None of the citations support the proposition, except the case of *Hoagland v. Bell*, which has been referred to.

(Reviewing cases, and criticising the statement from *Turnbull v. Payson* as obiter, except as applied to the particular facts of that case.)

The books and records of corporations, when properly kept, are evidence of the acts and proceedings of the corporate body, but can not be used to establish claims or rights of the corporation against third persons, unless pursuant to the sanction of some statute. Ang. & A. Corp., section 679. And they are not evidence against a stockholder in respect to a contract entered into by him with the corporation, notwithstanding he has access to them, because as to such a contract, he is regarded, not as a stockholder, but as a stranger. *Hill v. Water-Works Co.*, 2 Nev. & M. 573; *Haynes v. Brown*, 36 N. H. 545; *Hager v. Cleveland*, 36 Md. 476. In *Wharton on Evidence* (3d ed.), section 662, it is said that, in suits by a corporation against its members, its books can not be used as “proving in behalf of the corporation self-serving entries.” Such is the rule recognized by the adjudications of the courts of New York.

(Citing and commenting on *Bridge Company v. Lewis*, 63 Barb. 111; *Rudd v. Robinson*, 126 N. Y. 113.)

The true ground upon which the books of a corporation, showing who are shareholders, are admissible in evidence, is that they are the best evidence of the assent of the corporation to the contract of membership. Until that assent is proved, the contract is not complete, and no person who has bought shares of stock can be subjected to the liability of a stockholder. When it appears that a person has subscribed for or purchased shares, has voted upon them, has received dividends upon them, or in any other way has consented to occupy the relation of a stockholder, the contract of membership on his

part is shown; and the stock books become competent evidence, because they show that the corporation has likewise consented.

We approve the language of a recent commentator, which is as follows:

"On principle, the books and records of the corporation are not competent evidence to prove that the defendant is a stockholder; for the general rule is that one party to an alleged contract can not prove the existence of the contract by his own private memoranda or records. The mere statement of this principle ought to be enough to convince one of its correctness without argument." *Thomp. Corp.*, section 1924.

*Affirmed.*

*Note. Accord:* 1899, *Nat. Ex. & T. Co. v. Morris*, 15 App. D. (D. C.) 262; 1900, *Sigua Iron Co. v. Greene*, 104 Fed. (C. C. A. N. Y.) 854.

### Sec. 533. Same.

JOHN GLENN, TRUSTEE, v. M. M. ORR.<sup>1</sup>

1887. IN THE SUPREME COURT OF NORTH CAROLINA. 96 N. C. Rep. 413-416.

[Action to recover an unpaid balance due from an alleged subscription to the capital stock of an insolvent express company. It became necessary to prove the organization of this company, and that the appellee was the subscriber to ten shares of its stock. To do this the records of the corporation embracing what purported to be the proceedings in the organization under the charter, and to show that appellee had subscribed, had paid \$50 at one time on account, that the balance had been paid, and that he was a stockholder, were offered in evidence. Upon objection, these records were held not to be admissible to prove these facts. This ruling is the error assigned.]

MERRIMON, J. \* \* \* It was admitted on the trial, that the books and records offered in evidence, were those of the National Express and Transportation Company, and it must be taken from such admission, as there is no suggestion to the contrary, that the proceedings entered in them, and the orders and statements therein made, are regular, and made by the proper clerk, secretary or agent of the company, or some person authorized to make them. It must so appear, before such records and books can be received<sup>1</sup> as evidence for any purpose.

The records and books thus identified were evidence—certainly *prima facie* evidence—of the organization and existence of the company. They purport to set forth the proceedings of the organization, a list of the names of the stockholders, the number of shares of stock owned by each, when he subscribed for the same, the sum of

<sup>1</sup> Statement abridged.

money paid by each for his stock, and the sums due therefor remaining unpaid, and an account of its business transactions.

In *Turnpike Company v. McCarson*, 1 D. & B. 306, Chief Justice Ruffin said: "The case does not state the contents of the subscription and corporation books that were produced, and therefore we can not say positively of what they were evidence. We suppose them to be entries of such acts as the charter prescribed, as no deviation is specified. If so, those documents, when identified, were not only evidence, but complete evidence of the organization and existence of the corporation." The rule is so stated in *Ang. & Ames on Corp.*, sections 513, 514, 679; and so, also, *Turnpike Co. v. M'Kean*, 10 Johns. 154; *Gray's Turnpike Co.*, 4 Rand. (Va.) R., 578; *Owings v. Speed*, 5 Wheat. 420.

The books of the corporation offered in evidence, including the stock-book, purported to contain, as we have seen, a list of all its stockholders, the number of shares of stock owned by each, the sum of money paid, and the balance still due from each on account of his stock, and the name of the appellee appears as a stockholder, and his account is stated, showing a balance due from him for his stock.

These books were competent evidence to prove that the appellee was a stockholder, and the state of his account as such, in respect to his stock. It was so decided in the similar case of *Turnbull v. Payson*, 95 U. S. 418, in which the court say: "Where the name of an individual appears as a stockholder, the *prima facie* presumption is that he is the owner of the stock, in a case where there is nothing to rebut the presumption; and, in an action against him as a stockholder, the burden of proving that he is not a stockholder, or of rebutting that presumption, is cast upon the defendant." See, also, *Hamilton, etc., Plankroad Co. v. Rice*, 7 Barb. 157; *Coffin v. Collins*, 17 Me. 440; *Whitman v. The Granite Church*, 24 Me. 236; *Wood v. Railroad Co.*, 32 Ga. 273; *Hoagland v. Bell*, 36 Barb. 57; *Morawetz on Pr. Corp.*, section 270.

The rule of evidence underlying this and similar decisions seems to be founded in convenience, and to rest upon the further ground that corporations in this country are the creatures of statute, with prescribed rights and powers, subject, to an important extent, to public control and supervision, and are therefore presumed to exercise their powers as allowed and required by law, and to keep their records properly and truly. Such presumption may, of course, be rebutted by any competent evidence. This rule might in possible cases work injury to a party, but this is not probable, and though objected to on this ground, it has the less weight, as generally every litigant has the right to testify in his own behalf. *Turnpike v. M'Kean, supra*; *Owings v. Speed, supra*.

*Reversed.*

*Note. Accord:* 1896, *Holland v. Duluth Iron M. & D. Co.*, 65 Minn. 324, 60 Am. St. Rep. 480, note 486; also note 3 Am. St. Rep. 832, 859, 866; 1900, *Fish v. Smith*, 73 Conn. 377, 84 Am. St. R. 161; 1902, *Sherwood v. Trust Co.*, 195 Ill. 112, 88 Am. St. R. 183.

- Sec. 534.** (2) Right to vote.  
(a) Residence, proxy, and number of votes.

COMMONWEALTH, EX REL., v. J. J. DETWILER ET AL.<sup>1</sup>  
COMMONWEALTH, EX REL., v. C. L. HEMMINGWAY ET AL.

1890. IN THE SUPREME COURT OF PENNSYLVANIA. 131 Pa. St.  
Rep. 614-638, 7 L. R. A. 357.

[*Quo warranto* to test the validity of election of directors of the Farmers' and Mechanics' Institute, incorporated in 1856, under laws of 1840 and 1854, providing that "when any number of persons, *citizens of this commonwealth*, are associated" for purposes named they may be incorporated. In the first case all of the relators were residents of New Jersey, citizens of the United States and stockholders; in the second case one was an alien. In the first case the questions were whether persons not citizens of the state could vote, or could be a director, whether a shareholder could vote by proxy, or whether each member was entitled to only one vote, or one vote for each share held. At the meeting fourteen shareholders were present, five of whom voted for relators and nine for respondents; proxies of six others were held by one of the five and voted for relators. So that of the individual shareholders actually present (without reference to shares) a majority voted for respondents; and of those present in person and by proxy, a majority voted for relators. A majority of the stock voted by those actually present was for respondents; and a majority of that present in person and by proxy was for the relators. In the second case the question whether an alien, not a citizen of the United States, could be a shareholder, was raised. Upon these questions,

REEDER, J., in the common pleas court, held: (Must membership be restricted to citizens of the state?) Corporations are of two kinds: those in which the members have a personal right which can not be transmitted by sale, bequest, or inheritance, and those in which the members have a right of property. In the former, the right being merely personal and one which terminates by death or removal, and which can not be made the subject of sale, such as beneficial, literary and religious associations, the restriction of membership to citizens of the state or to those of a certain class, is in contravention of no constitutional provision, and such membership can therefore be restricted, limited and restrained. But it is not so with corporations which are in the nature of trading corporations, or where there may be profits to be divided, or where the membership by its organic law carries with it such a right of property as may be sold, bequeathed or inherited. To the latter class this company belongs.

The charter declares "That we, citizens of the United States." By its terms there was no limitation, other than that, to membership. Provision was made in the charter for the division of all excess of in-

<sup>1</sup> Statement abridged; only part of opinions given.

come as dividends upon the stock, as well as the division of the property at the dissolution of the corporation. \* \* \*

The second section of article IV of the constitution of the United States provides: "The citizens of each state shall be entitled to all privileges and immunities of the citizens of the several states." \* \* \*

"The inquiry is, what are the privileges and immunities of the citizens of the several states? \* \* \* They may all be comprehended under the following general heads: Protection by the government, the enjoyment of life and liberty, with the right to acquire and possess property of every kind. \* \* \* To take, hold and dispose of property, either real or personal." *Corfield v. Coryell*, 4 Wash. C. C. 380-1. "The complainants contend that the seven or thirteen persons mentioned in the law, who are to join in the articles of association, must be citizens of this state, and that the legislature did not intend to confer the privileges upon others. \* \* \* The legislature has not attempted to make any discrimination in the law against citizens of other states. The term it uses is 'persons.' Citizens of other states are, by virtue of the constitution of the United States declaring that the citizens of each state shall be entitled to all privileges and immunities of citizens in the several states, entitled to all the privileges to which citizens of this state are entitled under the law." *Central R. of N. J. v. Pennsylvania R. Co.*, 31 N. J. Eq. 486. To hold, therefore, that no one could hold shares of stock in the Farmers' and Mechanics' Institute by purchase, inheritance or bequest, except citizens of the state of Pennsylvania, would be in contravention of the express provisions of the constitution of the United States. \* \* \*

(After holding that relators were legally qualified to be directors.) Had the stockholders of this company a right to vote by proxy?

The charter contains no provision directly authorizing the casting of votes by proxy, but we find in it the following provision: "The mode of conducting elections and for filling vacancies by death or resignation, and the duties of the officers, shall be provided for by resolutions and by-laws." In the by-laws we find the following: "Article 1, section 12. In all elections members shall be entitled to one vote for every share of stock held by them respectively, which may be voted either in person or by proxy." The evidence discloses that 339 of the votes cast for the relators were cast by proxy. If these votes are illegal then judgment must be entered for the respondents.

The right to vote by proxy is not a common-law right. The authority to so vote must be conferred by proper provision somewhere. In this corporation the charter confers the power to provide for the mode of conducting elections by by-laws, and we also find a by-law authorizing votes to be cast by proxy. Is this sufficient? The charter confers upon the company the right to regulate the mode of conducting elections; the company passed, in pursuance of this authority, the by-law authorizing voting by proxy. This by-law was certainly within the provision of the charter authorizing the regulation of the mode of conducting elections.

In Cook on Stockholders, section 610, the author says: "When the charter is silent, the right to vote by proxy may in the absence of statutory provision be conferred by a by-law." Chancellor Walworth says: "The right of voting by proxy is not a general right, and the party who claims it must show a special authority for it, \* \* \* and it is possible that it might be delegated in some cases by the by-laws of a corporation, where express authority was given to make by-laws regulating the manner of voting." Phillips v. Wickham, 1 Paige 590. In the case of State v. Tudor, 5 Day 329 (5 Am. Dec. 162), the sole authority of the members of a corporation to vote by proxy was in a by-law. The court held such by-law conferred the right. In Morawetz on Corporations, section 486, the writer says: "That the right of voting by proxy may be conferred through a by-law adopted by the majority, appears to be reasonably well settled." That the right of voting by proxy may be conferred by a by-law seems inferentially to have been recognized by the supreme court of this state in the case of Commonwealth v. Brighthurst, 103 Pa. 134. Chief Justice Mercur says: "As the relators can not point to any language in the charter expressly giving a right to vote by proxy, and as it is not authorized by any by-law, they have no foundation on which to rest their claim." In view of these authorities, I conceive it to be lawful for the members of the Farmers' and Mechanics' Institute, under their by-laws, to vote by proxy, and that the votes so cast at the election on January 11, 1887, were legal votes entitled to be counted for the persons for whom they were cast.

Had each stockholder a right to cast a vote for each share of stock held by him; or was each member entitled to one vote and only one, regardless of the number of shares of stock he held?

Under the act of October 13, 1840, among the enumeration of powers conferred, we find this provision: "And shall be authorized and empowered, and they are hereby authorized and empowered, to make rules, by-laws and ordinances and do everything useful for the good government and support of said corporations respectively; provided, also, that the said by-laws, rules and ordinances, or any of them, be not repugnant to the constitution and laws of the United States, to the constitution and laws of this commonwealth, or to the instrument upon which the said corporations respectively are as aforesaid formed and established." In the charter of this corporation we find the provision that "the mode of conducting elections \* \* \* shall be provided for by resolution or by-laws." In the by-laws we find: "Article I, section 12. In all elections members shall be entitled to one vote for every share of stock held by them respectively," etc.

A by-law not inconsistent with the constitution and laws of the United States, or the constitution and laws of Pennsylvania, or with the charter, is a valid, lawful by-law. In Morawetz on Corporations, section 476, the author says: "It seems that at common law each shareholder is entitled to cast but one vote. But there are good reasons for holding that this rule has no application to ordinary joint stock business corporations of the present day." In Cook on Stock



and Stockholders, section 608, we find the following: "At common law, in public or municipal corporations, each elector has one vote and only one. This rule has been applied to stockholders in a private corporation, and it has been held that such a shareholder has but one vote, although he be the owner of many shares of the capital stock. Almost universally, however, the charter of a company, or a statute, or a constitutional provision, gives to each share of stock one vote at every corporate meeting, and at the present day it is probable that no court, even in the absence of such provision, would uphold a rule which disregards in the matter of voting the number of shares which the shareholder holds in the corporation."

If this provision in regard to stock voting had been incorporated in the charter, there could be no doubt that it would confer upon the stockholders the right to cast one vote for each share of stock held by them. Vide *Commonwealth v. Brighthurst*, 103 Pa. 134. The charter, however, contains the provision that the method of conducting the elections shall be provided for by the by-laws, and this by-law is adopted by the company in accordance with this authority. Is not this as binding upon the stockholders of the corporation as if it were embodied in the charter itself?

(In first case, judgment for relators. In the second case, Peter Robinson is not eligible to serve as a director for the reason he is not a citizen of the United States. Appeals taken.)

MR. JUSTICE WILLIAMS (in the supreme court, in the first case).  
\* \* \* The second and third questions must be answered in the affirmative. The non-resident stockholder takes his shares with all the rights and privileges which pertain to them in the hands of a citizen, and he may vote upon them, and, where no other qualification than ownership of stock is required of the directors, he may become a director. We put the right of the stockholder, not so much on the provision of the constitution of the United States, which was discussed with so much learning by the judge of the court below, as upon the nature of the stock as a personal chattel, and the right of an alien friend at the common law to deal in personal goods, embark in trade, loan money, sue and be sued for the collection of debts, and the protection of his person and personal estate.

The fourth and fifth questions relate to the right of a stockholder to cast more than one vote, if he owns more than one share of stock, and his right to vote by proxy. A corporation is a voluntary association of persons engaged in a common enterprise. When the methods of voting are not fixed by general law, the corporators may make the law for themselves, subject to the qualification that such laws and regulations as they make shall not conflict with the laws of the state or of the United States. The general law did not touch either of the questions now raised, and for that reason the corporators or stockholders took them up, and made a law for themselves, covering both subjects. They have provided that stockholders shall have one vote for each share held by them up to ten shares, and they have fixed the proportion which his votes shall bear to his shares above that number.

This is a reasonable regulation; it is uniform in its operation; it conflicts with no law, and it is binding on all the shareholders. The same thing may be said in regard to voting by proxy. It was competent for the members of this association to consider what was most convenient for themselves, and best calculated to secure the votes of all the shareholders at the annual elections. They had the power to refuse to receive votes unless offered by the voters in person, but, upon consideration, they decided that votes might be cast by proxy. This also was a reasonable regulation, uniform in its application, works no wrong to any shareholder, and conflicts with no law of the commonwealth. It is therefore a valid and binding law, made by the shareholders for their own government.

(In the second case, as to the right of the alien.) \* \* \* For the reasons given in *Detwiler v. Commonwealth*, *supra*, we think he may become a stockholder. The stock being personal property, he may acquire it by gift or purchase. An alien could at common law buy personal goods, and sell them, and, except in the case of an alien enemy, there was no restriction upon trade with aliens. If he can acquire the stock, he can acquire with it all the rights and privileges which its ownership confers, among which is the right to have a voice in the control of the enterprise, and the selection of those who are to conduct its affairs. He may therefore vote in the same manner, and with the same effect, as any other stockholder may do. Why may he not become a director? The office is not a political one. If it was, he would, of course, be ineligible to it, and disqualified for voting for any one else to fill it, because of his want of citizenship. \* \* \*

The learned judge who tried this case in the court below thought that the right of the citizens of New Jersey to become stockholders, to vote, and to hold office in this association, rested on the constitution of the United States, and, logically enough, held that one who was not a citizen of the United States could not become a director; but we think the right of all persons, not alien enemies, to buy and hold, use and enjoy, personal property, whether corporate stocks or articles of merchandise, is older than the constitution, and that citizenship of the United States is not necessary to its exercise. Even as to real estate, the distinction between a resident alien friend and a citizen has disappeared in Pennsylvania and nearly every other state in the Union. The words of our act of 1807 are: "It shall and may be lawful for any alien or aliens, actually resident within this commonwealth, and not being the subject or subjects of some sovereign state or power which is, or shall be at the time or times of such purchase or purchases, at war with the United States of America, to purchase lands, tenements, and hereditaments within this commonwealth, and to have and to hold the same in fee-simple, or for any lesser estate, as fully, to all intents and purposes, as any natural-born citizen or citizens may or can do."

(In first case, judgment affirmed; in second, reversed.)

*Note.* 1. *Proxy voting.*

*As to right to vote by proxy:* See, 1834, Taylor v. Griswold, 14 N. J. L. 222, 27 Am. Dec. 33; 1883, Commonwealth v. Bringham, 103 Pa. St. 134, 49 Am. Rep. 119; 1895, Market St. R. Co. v. Hellman, 109 Cal. 571.

*Irrevocable proxies:* All attempts to create irrevocable proxies, at least if not coupled with an interest, have been held to be ineffective, and may be revoked. See, 1889, Vanderbilt v. Bennett, 6 Pa. Co. Ct. 193; 1891, Cone v. Russell, etc., 48 N. J. Eq. 208; 1897, Schmidt v. Mitchell, 101 Ky. 570, 72 Am. St. Rep. 427. See, also, note, 50 Am. St. Rep. 130.

Compare, 1895, Hey v. Dolphin, 92 Hun (N. Y.) 230.

2. *Number of votes:* See, 1895, Proctor Coal Co. et al. v. Findlay et al., 98 Ky. 405, 33 S. W. Rep. 188; Harvard L. R. 1888, p. 156.

Sec. 535. Same. (b) Personal interest of shareholder.

#### BJORNGAARD v. GOODHUE COUNTY BANK.<sup>1</sup>

1892. IN THE SUPREME COURT OF MINNESOTA. 49 Minn. Rep. 483-488.

GILFILLAN, C. J. The defendant bank is a banking corporation. The defendants, Sheldon, Perkins, Featherstone, Brooks, Boxrud and William and Frederick Busch, and the plaintiff Hoyt, were at the times hereinafter mentioned, and now are, its directors. The director defendants were and are stockholders, owning a large majority of the stock. The plaintiffs are stockholders. The defendant stockholders owned a lot and building. At a directors' meeting on July 7, 1890, all the directors being present, it was resolved, all the directors except Hoyt, who protested, voting in the affirmative, that the corporation purchase at a price specified said lot and building, and on July 11 the owners executed a conveyance to the bank. The action is brought to set aside the transaction, and to prevent the funds of the bank being used to complete the purchase, and also to prevent a ratification by the stockholders, a meeting of whom had been called for the purpose, or, rather, to prevent such a ratification by the votes of defendants. There is no doubt that, within the rule in Rothwell v. Robinson, 39 Minn. 1, 38 N. W. Rep. 772, the plaintiffs may bring such an action without first applying to the corporate authorities to bring it. The directors against whom complaint is made are not only a majority of the directors, but they own a majority of the stock, so that any application either to the board of directors or to the body of stockholders to bring the action would be equivalent to asking the alleged wrongdoers to bring suit in the name of the corporation against themselves. The law does not require of the minority stockholders to do so absurd a thing as a condition of seeking relief against the wrongful acts of the directors and majority stockholders. The court below decided the case in favor of the defend-

<sup>1</sup> Statement, except as given in opinion, and arguments omitted.

ants on the proposition that although the act of the board of directors was voidable, it was not *ultra vires*, and was capable of ratification; and where a majority of the stockholders have power to ratify the unauthorized act of the directors, courts will not interfere. We see no reason to think this purchase was *ultra vires*,—that the corporation had not power to make it. And, that being so, it may be conceded that the board of directors had authority to make a purchase for the corporation. And it is undoubtedly true that where a corporation has power to do a certain thing, though the authority to do it is not in the directors, the stockholders may ratify their act if they assume to do it on behalf of the corporation. But this transaction is not voidable because *ultra vires*,—because there was no authority in the directors to purchase; but it is voidable under the rule that one having authority from another to purchase or sell for him can not purchase from nor sell to himself. To do so is in law a fraud. The rule is absolute, and the matter of fraud in fact is immaterial. The party for whom the purchase or sale is made need not allege nor prove fraud or injury but may disaffirm without taking any risk. The rule is inflexible, in order to prevent fraud on the part of one holding a fiduciary relation, by making it impossible for him to profit by it, thus removing temptation from his way. This court has steadily adhered to and applied the rule since it first enunciated it in *Baldwin v. Allison*, 4 Minn. 25 (Gil. 11). But in all cases of the kind the principal may, with full knowledge of the facts, ratify what has been done. The act of the defendant directors was a violation of this rule, and the purchase was not binding on the corporation until ratified. The question is therefore presented, under the allegation and relief asked in the complaint, had the defendants a right to vote as stockholders at the stockholders' meeting called for the purpose upon the question of ratification? While stockholders in a corporation owe the duty of good faith to each other in the management of the affairs of the corporation, they do not stand to each other in a fiduciary relation within the rule we have stated. They are not trustees nor agents for each other in the matter of voting upon any proposition that may come before a meeting of the stockholders. In voting, each must be guided by his own judgment as to what is for the best interest of the corporation. The fact that he may have a personal interest, separate from the others or from that of the corporation in the matter to be voted upon, does not affect his right to vote. It is not to be understood that the majority stockholders may use their power of voting for the purpose of defrauding the minority. It was said in *Gamble v. Queens Co. Water Co.*, 123 N. Y. 91, 25 N. E. Rep. 201, in which the right of a stockholder in such a case to vote was affirmed: "In such cases it may be stated that the action of the majority of the shareholders may be subjected to the scrutiny of a court of equity at the suit of the minority shareholders." And in *Beatty v. Transportation Co.*, L. R. 12 App. Cas. 589, in which the same thing was held, it was said, in effect, that in such case the ratification must not be brought about by unfair or improper means, nor be illegal or fraudulent or oppressive towards

those shareholders who oppose it. A rule excluding stockholders from the right to vote merely because they might be personally interested to vote in a particular way, contrary to the interests of the other stockholders, would be likely to lead to great confusion. The rule laid down in the two cases cited is sufficient to secure the exercise of the good faith which one stockholder owes to the others.

*Judgment affirmed.*

*Note. Accord:* 1877, Pender v. Lushington, L. R. 6 Ch. D. 70; 1887, Beatty v. N. W. Trans. Co., L. R. 12 App. Cas. 589, 12 Can. Sup. Ct. 598, 11 Ont. App. 295, 6 Ont. 300; 1903, Hodge v. U. S. Steel Corp., — N. J. —, 60 L. R. A. 742.

Compare, 1870, Gamble v. Water Co., 123 N. Y. 91; 1876, Guernsey v. Cook, 120 Mass. 501; 1896, Gage v. Fisher, 5 N. Dak. 297, 31 L. R. A. 557; 1901, Jones v. Green, 129 Mich. 203, 95 Am. St. R. 433.

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**Sec. 536. Same. (c) Pledgor and pledgee.**

HOPPIN ET AL. V. BUFFUM ET AL.<sup>1</sup>

1870. IN THE SUPREME COURT OF RHODE ISLAND. 9 R. I. Rep. 513-519.

[Information in nature of *quo warranto* to test the validity of the election of respondents as directors of the P. & N. Y. Steamship Company.]

POTTER, J. In this case the material facts are, that a certain number of shares in the corporation, owned by Edward P. Taft and Cyrus Taft, were pledged to Earl P. Mason as security for debts due to himself and others; but neither the ownership nor the pledge appeared on the books of the corporation, where the stock had, from the formation of the corporation, stood in the name of "Earl P. Mason, trustee." The certificate was so issued, and he had always voted thereon, without objection, until the meeting of June 9, 1870, and voted upon them at that meeting, no objection having been made until while the votes were being counted, or, as some of the affidavits say, after they were counted. It is not disputed that the votes so thrown decided the election made on that day. It is claimed, on one side, that the person who then made the protest stated that said Mason held the stock as security only. This is denied, on the other side.

A person who pledges stock has the right to vote upon it until the title of the pledgee to the stock is perfected. Case of Jacob Barker, 6 Wend. 509. If Taft had appeared on the books as owner, and the books had shown the pledge, Mr. Taft's right to vote on the stock could not have been disputed. The object of the stock-book, and of requiring transfers of stock to be recorded by the corporation, is for the protection of the corporation, to enable it to know who are its members who are entitled to dividends; and for no purpose is it more important than to enable it to know who are entitled to vote in

<sup>1</sup> Statement abridged. Arguments and part of opinion omitted.

case of an election. This doctrine is recognized by many authorities expressly, and by many others impliedly. *Gilbert v. Manufacturing Iron Co.*, 11 Wend. 627; *Bank of Utica v. Smalley*, 2 Cow. 770, 778; *Kirtright v. Bank of Buffalo*, 22 Wend. 348, 362; *Fisher v. Essex Bank*, 5 Gray 373, 380; *Hoagland v. Bell*, 36 Barb. 57, 58.

And we think that in a case of a dispute as to a right to vote, the books of the corporation are the *prima facie* evidence; at any rate, the corporation can not be required to decide a disputed right. Of course, if the pledgor and pledgee, or the trustee and *cestui que trust*, agree that either shall represent the stock, or if the facts are admitted, that might be sufficient. Upon any other rule, it could never be known who were entitled to vote, until the courts had decided the dispute. The corporation or its officers would have to decide it for the time, and it would leave the election in uncertainty.

If the real owner wishes to have his name, or the true state of facts, appear on the books, he has his remedy in equity to compel a proper transfer, or to compel the pledgee to give a proxy, as was done in the case of *Vowell v. Thomson*, 3 Cranch C. C. 428. But when the real owner or pledgor acquiesces for years in the control of the stock by the record owner, and without any attempt to inform the corporation of the true state of facts until a contested election occurs, and then, not until the votes are being counted or have been counted, we do not think he presents a proper case to justify a court of equity in interfering with the result of the election as declared. See *State v. Lehre*, 7 Rich. (Law) 234, 256, 325. In the present case the stock stood in the name of Earl P. Mason, trustee. The books did not disclose the nature of the trust. If any other person was the equitable owner of the stock, and entitled to have it transferred to him, he should, if his right was disputed, assert it in season, and take the proper measures to enforce it. But if the trust was of such a nature that the trustee has the control and management of the property, and is to exercise his discretion concerning it, then he is the proper person to represent and vote upon it. And the corporation can not be required to examine into the nature of the trust, with a view to decide as to the right to vote.

*Judgment for respondents.*

*Note:* 1893, *Commonwealth v. Dalzell*, 152 Pa. St. 217, 34 Am. St. Rep. 640; 1898, *National Bank v. Allen*, 90 Fed. Rep. (C. C. A.) 545. Compare, 1887, *State v. Smith*, 15 Ore. 98; 1900, *Wentworth Co. v. French*, 176 Mass. 442, 57 N. E. Rep. 789; 1901, *Jones v. Green*, 129 Mich. 203, 95 Am. St. R. 433.

Bondholders can not be authorized to vote: 1895, *Durkee v. People*, 155 Ill. 354, 46 Am. St. Rep. 340.



## Sec. 537. Same. (d) Executors.

TUNIS ET AL. v. HESTONVILLE M. &amp; F. PASS. R. R. CO. ET AL.

1892. IN THE SUPREME COURT OF PENNSYLVANIA. 149 Pa. St. Rep. 70-85.

[Bill in equity praying for a master to preside at the annual meeting of the railroad company, alleging former acts of fraud and alleging probable grounds for believing the next election would be accompanied by fraud and violence. The master was appointed by the lower court, and at the election there was much contention as to voting 6,900 shares belonging to the estate of Charles Lafferty, deceased.]

MR. CHIEF JUSTICE PAXSON. \* \* \* The master has found, the facts elaborately, from which we condense the following: The will of Charles Lafferty, deceased, provides that the executors and trustees shall always be three in number. The present executors and trustees are Charles H. Lafferty, Rose E. Lafferty and F. J. Corcoran. By a codicil to his will he provides as follows: "I do hereby authorize and direct that all the stock held by me in the Race and Vine streets, Arch street, and Hestonville, Mantua & Fairmount Passenger R. Company, shall be voted at all elections of said companies as my son, Charles Lafferty, shall direct and appoint, and my executors are directed to give a proxy or authority to vote said stock as he may desire to vote the same." The other two executors refused to give Charles H. Lafferty the proxy mentioned in the codicil, and protested, as before stated, against his right to so vote the stock. The judges of election announced that, unless otherwise instructed by the master, they would receive the ballot tendered by Charles H. Lafferty, and count it as he requested. If this ballot should be received and counted as desired by him, it would elect the Lafferty ticket. The master sustained the objection to this ballot, and directed the judges of election to reject it, which was accordingly done.

The master has given abundant reasons for his ruling. The principle may be briefly stated thus: At a corporate election, each vote cast and counted must be so cast in person or by proxy. This is the law of the corporation, and the stock can not be voted in any other way.

The codicil to Mr. Lafferty's will was not a proxy, and could not be treated as such as to objecting owners or stockholders. A proxy is an authority or power to do a certain thing; in this case a power to vote stock. Such power can only be given by the owner. It can not, of course, be given by a dead man. Charles Lafferty no longer owns this stock for the reason that his ownership terminated with his death. It then passed, by his will, to the executors and trustees before named, in trust for certain beneficiaries. The executors were entitled to vote this stock, because they held the legal title

for the beneficial owners. If we concede that one executor could vote the stock, in the absence of objection by his co-executors, it is clear that he could not vote it against such objection. It is true, the codicil to the will directs two of his executors to give a proxy to Charles H. Lafferty, for the purpose of enabling him to vote his stock, but they did not give such proxy, nor does it appear that any attempt was made to enforce the provisions of the codicil by any legal proceeding. We are not called upon to say whether the dissenting executors could have been compelled to give the other executor a proxy. In point of fact, they did not give one, and, under the law of the corporation, the stock could not be voted. The testator could not, by a codicil to his will, affect the rights of other corporators. The codicil, so far as the corporation was concerned, had no legal effect.

What has been said in regard to Charles H. Lafferty's right applies, with equal force, to the attempt of the other two executors to vote the stock against his objection. The right of voting stock is inseparable from the right of ownership. The one follows as a sequence from the other, and the right to vote can not be separated from the ownership, without the consent of the legal owner. It follows, logically, that one joint-owner of stock can not vote it against the protest and objection of his co-owner.

It is not needed, for the purposes of this case, that we should speculate as to the right of a man to control, from his grave, the election of directors of a corporation. No such question is legitimately raised by this record. It will be time enough to decide this grave question when it arises.

The decree affirmed, and the appeal dismissed, at the costs of the appellants. See 1901, *Jones v. Green*, 129 Mich. 203, 95 Am. St. R. 433.

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**Sec. 538. Same. (e) Corporation holding its own shares.**

**AMERICAN RAILWAY-FROG COMPANY v. HAVEN ET AL.<sup>1</sup>**

1869. IN THE SUPREME JUDICIAL COURT OF MASSACHUSETTS. 101  
Mass. Rep. 398-408.

[Petition for mandamus by the company to declare certain officers elected and commanding the delivery of the books of the corporation. It was shown that after the corporation was organized and the stock issued, different shareholders transferred four hundred shares to Aaron Clark, treasurer, "to hold for the benefit of the corporation." At the election in controversy persons holding a majority of shares exclusive of these four hundred, elected officers, who instituted this suit; the old secretary and treasurer refused to deliver the books or recognize the validity of the election.]

<sup>1</sup> Statement abridged. Only that part of opinion relating to the single point is given.

AMES, J. \* \* \* The case finds that the capital stock was divided into two thousand shares, all of which were properly issued to the original stockholders; and that some time afterwards four hundred of these shares were transferred by some of the stockholders to Aaron N. Clark "to hold for the benefit of the corporation." If these transfers had been made directly to the corporation, without the intervention of a trustee, it would hardly be contended that it would thereby become entitled to vote at a meeting of stockholders. A corporation can not literally be one of its own stockholders in the full sense of that term. Such a transfer might not operate as a mere surrender or cancellation of stock, unless so intended. It would not diminish the amount of the capital, nor necessarily reduce the number of shares. The corporation might, perhaps, receive such a transfer, and hold the stock so conveyed to it, for the purpose of reissue to new subscribers or purchasers. By the terms of the transfer, Clark holds "for the benefit of the corporation," and of course subject to its order. This is the extent of his trust. Nothing in the nature of it makes it necessary that he should vote, as the holder of those shares. There is no apparent reason why he, not being beneficially or practically the owner of them, should be endowed with the privilege of controlling four hundred votes according to his own judgment or pleasure, especially when it is taken into consideration that the corporation for which he holds them has no right of voting in any event. It is easy to see that any such privilege would not only be unreasonable and unfair, but might lead to great abuses. The position of these shares, in our judgment, is the same, to all intents and purposes, so far as the right of voting upon them is concerned, as if they were held directly by the corporation itself; and, until they are sold and transferred by its authority, the right of voting upon them is suspended. *Ex parte Holmes*, 5 Cowen 426; *Ex parte Willcocks*, 7 Cowen 402. It follows, then, that at the annual meeting in question, the votes on these four hundred shares ought not to have been received or counted; that the whole number of competent and legal votes was fifteen hundred and thirty-three, and no more; that Cuntz and his five associates received a clear majority of these votes; and that they were duly elected to the offices claimed for them respectively in the petition.

*Peremptory mandamus to issue.*

*Note.* Compare, 1889, *Memphis, etc., R. Co. v. Woods*, 88 Ala. 630, 16 Am. St. Rep. 81; 1890, *Mack v. De Bardeleben & Co.*, 90 Ala. 396. ,

Sec. 539. Same. (f) Cumulative voting.

PIERCE v. THE COMMONWEALTH.<sup>1</sup>

1883. IN THE SUPREME COURT OF PENNSYLVANIA. 104 Pa. St. Rep. 150-156.

[*Quo warranto* requiring Pierce and his associates to show by what authority they exercised the office of directors of the Sharpsville Railroad Company. No irregularity as to the calling or holding the election was charged; but when the votes were to be counted it appeared that all of those for the four relators had been cumulated, and were folded up and indorsed with the name of the voter, and the number of shares voted. Prior to the counting no one had claimed the right to cumulate his vote, and the judges of election refused to count them, and declared respondents elected. The lower court instructed the jury that the relators had the right to do this in the case of railroad companies and without first giving notice. Verdict for relators, and judgment of ouster against respondents, who allege error in the charge of the court.]

GORDON, J. About the correctness of the ruling of the learned judge of the court below, in this case, we have no doubt. It seems to have been admitted, in the outstart of this trial, that the election of the 8th of January, 1883, was properly called, was held at the proper time, and was conducted in an orderly and regular manner. Nor is there any doubt but that the relators received the highest number of votes cast for directors at that election. It is said, however, that this result was brought about by the cumulation of the votes of the relators upon four out of the six candidates proposed for election. But this they certainly had a right to do, or we fail correctly to read the constitution of 1874: "In all elections for directors or managers of a corporation, each member or shareholder may cast the whole number of his votes for one candidate, or distribute them upon two or more candidates, as he may prefer." Article 16, section 4. This section to us seems very plain and unambiguous. If there are six directors to be elected, the single shareholder has six votes, and, contrary to the old rule, he may cast those six votes for a single one of the candidates, or he may distribute them to two or more of such candidates as he may think proper. He may cast two ballots for each of three of the proposed directors, three for two, or two for one, and one each for four others, or finally, he may cast one vote for each of the six candidates. Now, as this Sharpsville Railroad Company was incorporated since the adoption of the new constitution, it is necessarily subjected thereto, and must be governed by its provisions. But the provision above cited vested in the relators, as stockholders, the absolute right to vote as they did, and if, as a consequence of the exercise of such right, their candidates had the highest number of

<sup>1</sup>Statement abridged, arguments and part of opinion omitted.

votes cast at that election, they are the rightful directors of the corporation. But it is said this provision is but directory, and it can not go into effect without some legislative action directing the manner of its exercise. To this proposition we can not assent. There is no alteration required in the mode of conducting corporate elections; each company continues to use that method prescribed by its charter, and the constitutional right is one that belongs solely and exclusively to the individual shareholder. He may exercise it or not as to him may seem proper, but whether he does so exercise such right or not, the ordinary manner of conducting the corporate election is in no wise interfered with. Legislative action is, therefore, uncalled for; it would be useless to alter the present mode of election, and with the right itself the general assembly can not meddle.

(After holding that a railroad was a private corporation, to which the constitutional provision applied, and prior notice of intention to cumulate votes was not necessary, the judgment was affirmed.)

*Note.* See, 1883, *State v. Greer*, 78 Mo. 188; 1885, *Wright v. Cent. Cal.*, etc., Co., 67 Cal. 532; 1891, *Cross v. Railway Co.*, 35 W. Va. 174; 1900, *Schwartz v. State*, 61 Ohio St. 497; 1900, *Looker v. Maynard*, 179 U. S. 46, affirming *Attorney-General v. Looker*, 111 Mich. 498.

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**Sec. 540. Same. (g) Voting trusts.**

**HARVEY v. LINVILLE IMPROVEMENT COMPANY.<sup>1</sup>**

1896. IN THE SUPREME COURT OF NORTH CAROLINA. 118 N. C. Rep. 693-700, 54 Am. St. Rep. 749, 32 L. R. A. 265.

[Action by Harvey for an injunction against the company and M., D. and L., to have a pool agreement and an issue of bonds set aside, in order that he might complete purchases of the majority of the capital stock of the company and obtain control thereof. The company was in the hands of a receiver, and while so, a number of shareholders, including H., W. and K., in order to extricate the company, pay its debts, and enable it to resume operations, entered into a "pool" to place their stock in the hands of M., D. and L., in trust for five years, to borrow money and pay off debts of the company, and pledge the stock to secure the payment of the money borrowed, with power to vote the stock at all meetings, as should be determined by the majority of owners. The trustees did borrow \$9,000 and pledged the stock, including that of H., W. and K., which Harvey claimed to have purchased after the pool was entered into. At a meeting held soon afterword, in which the stock was voted by the owners, and not under control of the pool, it was voted to issue \$60,000 first mortgage

<sup>1</sup> Statement abridged. The pool agreement is set out in full in the original report, page 696, and shows the form of such contracts.

bonds, in order to pay the debts and get the property released from the receivership. Harvey had an option upon enough of the shares of stock to give him control of the company, if the pool agreement could be broken. The injunction was denied below, and Harvey appealed.]

CLARK, J. At common law stockholders could not vote by proxy. *Taylor v. Griswold*, 14 N. J. Law 222, and other cases cited in Cook on Stocks, section 610. This is now otherwise, but it is still held that each stockholder, whether by himself or by proxy, must be free to cast his vote for what he deems for the best interest of the corporation, the other stockholders being entitled to the benefit of such free exercise of his judgment by each; and hence, any combination or device by which any number of stockholders shall combine to place the voting of their shares in the irrevocable power of another is held contrary to public policy. *Cone v. Russell*, 48 N. J. Eq. 208. Various devices have been resorted to for the purpose of so tying up the stock that no one of the parties to the "pool" or combination can break the agreement. "Irrevocable" proxies to vote the stock have been given to a designated party who acted as trustee or agent, but the courts held such proxies not irrevocable, and that they might be revoked at any time. Cook, *supra*, sections 610, 622; *Woodruff v. Dubuque*, 30 Fed. Rep. 191; *Vanderbilt v. Bennett*, 6 Pa. Co. Ct. 193. Another plan was to place the stock of the various parties in the hands of trustees, with power to transfer the stock to themselves and to hold and vote the same, trustees' certificates being issued to the various parties, specifying the amount of stock so deposited by them and their interest in the pool, but the courts held that any holder of a trustee's certificate might at any time demand back his part of the stock. *Woodruff v. Dubuque*, *supra*, and other cases cited in Cook, *supra*, section 622. Another device was that the parties contracted together not to sell their stock for a specified time or only to a purchaser acceptable to them all. It was held that notwithstanding such contract any one of the parties might sell his stock to any one he pleased and at any time. *Fisher v. Bush*, 35 Hun 641; *Williams v. Montgomery*, 68 Hun 416. Another plan was to restrict by a by-law the right to transfer stock, but this was held illegal. *Morgan v. Struthers*, 131 U. S. 246, and other cases cited in Cook, *supra*, section 332. A provision that a purchaser of a certificate of stock who sold in violation of the agreement should be entitled to the dividends, but should receive no right to vote, was likewise held invalid. *Harper v. Raymond*, 3 Bosw. (N. Y.) 29.

Numerous decisions affirm the correctness of the above rulings, which are based upon the illegality, because against public policy, of permitting large blocks of stock to be irrevocably tied up for the purpose of being voted *in solido* for the interest of a clique or section of the stockholders, and not according to the judgment of each individual stockholder for the benefit of the entire corporation. There are some few decisions trenching more or less upon the principles above stated, but we deem them contrary to sound principle of public



policy, and hence not authority. In short, all agreements and devices by which stockholders surrender their voting powers are invalid. 5 Thompson Corporations, section 6604. The power to vote is inherently annexed to and inseparable from the real ownership of each share, and can only be delegated by proxy with power of revocation. The "pooling" arrangement, admitted to have been entered into by the majority of stockholders in the present case, is contrary to public policy and voidable (*Woodruff v. Dubuque, supra*), and the plaintiff, assignee of certain of the trustees' certificates, is entitled to have his name entered as the owner and holder of the shares of stock represented by said trustees' certificates, and to have said shares issued to him, should the facts be found in accordance with his allegation, and to have the defendant restrained till the hearing from voting or controlling in any way the stock purchased by the plaintiff, or in anywise interfering with plaintiff's right to vote, control or dispose of said stock.

*Error.*

*Note. Accord:* 1900, *Kreissl v. Distilling Co.*, —N. J. Ch. —, 47 Atl. 471. See next case and note. Also, article, 64 Alb. L. J. 187 (June, 1902).

Sec. 541. Same.

SMITH ET AL. V. SAN FRANCISCO & NORTH PACIFIC RAILWAY COMPANY ET AL.<sup>1</sup>

1897.. IN THE SUPREME COURT OF CALIFORNIA (IN BANK). 115  
Cal. Rep. 584-610, 56 Am. St. 119, 35 L. R. A. 309, 6 A. & E.  
C. C. (N. S.) 205.

[At an election of the railway company, February 25, 1896, votes offered by one Smith, in whose name certain shares stood on the books, were rejected, in consequence of which certain parties were declared elected directors in place of others who would have been elected had the votes of Smith been received as offered by him. In 1893 the estate of D., deceased, was the owner of forty-two thousand shares of the company, which in the settlement of the estate were ordered to be sold; Smith, Foster and Markham, prior to the sale, entered into an agreement for the purchase of the stock as an entirety, and proposed to enter into another agreement, if the purchase should be made, whereby the shares should for the term of five years be voted as a unit in the election of directors; at the sale their bid was accepted, the stock purchased, and one-third (except five thousand shares left in trust for another purpose), was transferred upon the books to each of these parties. Smith drew up the agreement for voting the stock as contemplated, and this was duly executed, it being "mutually agreed between said Foster, Markham and Smith that they will, during

<sup>1</sup> Statement abridged; part of the opinion of Harrison, J., and all of dissenting opinion of Beatty, C. J., omitted.

said period, retain the power to vote said shares in one body; and that the vote which shall be cast by said shares, whether for directors or for any other purpose, shall be determined by ballot between them or their survivors." It was to last five years, apply to their vendees as well as themselves, and was "for the purpose of keeping control of the road in the interest of themselves, and of all persons who shall buy any portion of the stock from them." Before the election, at a conference of the parties, it was determined by the vote of Foster and Markham that these shares should be voted for certain persons as directors; at this meeting Smith gave notice that he did not recognize the validity of the agreement, and would not be bound by it; and at the election of directors offered to vote upon his part of the stock; but this was rejected, and the whole forty-two thousand shares were voted as Foster and Markham directed; Smith protested, and brought suit to have the election set aside; the lower court gave judgment in favor of Smith, mainly on the ground that the agreement did not amount to a proxy "which gave any authority to any other person to cast the vote of Mr. Smith." Motion for new trial was overruled.]

HARRISON, J. \* \* \* (After passing upon another question, and also holding that the agreement "to determine" by ballot between them the vote which "shall be cast," by necessary implication gave a power to cast the ballot in accordance with this determination, proceeds:) The instrument executed between the parties must, therefore, be held to be a proxy, and to authorize the vote of the forty-two thousand shares of stock to be cast in accordance with the determination of the majority of the parties thereto, and, if it was made upon a consideration sufficient to bind the parties to its enforcement, it must be regarded as still operative. One of the inducements for the purchase of the stock, and under which the parties entered into the agreement, was that the shares should be voted in one body, and held for five years as a unit. It is immaterial that the voting agreement was not reduced to writing and executed until after the bid had been made for the stock. It was so executed before the parties thereto had completed the purchase and become the owners of the stock by paying the purchase-price. Nor is the validity of the agreement or the effect of its terms different by reason of different certificates having been issued in the names of the several parties to the transaction, rather than in the name of one of them. The agreement between them was with reference to the forty-two thousand shares of stock, and that it should be voted as a unit, and the purpose of the agreement was the economical management of the road, and to prevent irresponsible persons from getting control. It was within the power of the parties to contract in reference to this property as fully as with regard to any other property. They were at liberty to make as a condition of their purchase that its management should be held by either of them, or by a majority of the three, and the terms of the agreement for such purchase could not be repudiated by either after the purchase had been made. It may be assumed that neither of the parties would have entered into the transaction, or agreed upon the purchase of the stock,

except upon these conditions, and it must be held that each contributed his money to the purchase of the stock upon the promise made to him by the others. There was thus a sufficient consideration for the agreement granting the right to vote the stock. It was in the nature of a power coupled with an interest, and, being given for a valuable consideration, could not be revoked at the pleasure of either. *Hey v. Dolphin*, 92 Hun 230.

Although the court, in excluding this evidence, assumed that the instrument was valid, counsel for respondents have presented an argument in support of their further objection thereto, that the instrument is invalid by reason of being against public policy, and it therefore becomes necessary to consider this objection, inasmuch as the action of the court, rather than its reason for so acting, is to be reviewed; for, if the instrument is invalid, the refusal of the court to allow any effect to be gained from its exercise was proper.

“Public policy” is a term of vague and uncertain meaning, which it pertains to the law-making power to define, and courts are apt to encroach upon the domain of that branch of the government if they characterize a transaction as invalid because it is contrary to public policy, unless the transaction contravenes some positive statute or some well-established rule of law. Sir George Jessel, as master of the rolls, said, in *Besant v. Wood*, L. R. 12 Ch. Div. 605, that public policy is “to a great extent a matter of individual opinion, because what one man or one judge might think against public policy, another might think altogether excellent public policy;” and in another case (*Printing, etc., Co. v. Sampson*, L. R. 19 Eq. 465), the same jurist said: “If there is one thing which more than another public policy requires, it is that men of full age and competent understanding shall have the utmost liberty of contracting, and that their contracts, when entered into freely and voluntarily, shall be held sacred, and shall be enforced by courts of justice.” It is not in violation of any rule or principle of law for stockholders, who own a majority of the stock in a corporation, to cause its affairs to be managed in such way as they may think best calculated to further the ends of the corporation, and for this purpose, to appoint one or more proxies who shall vote in such a way as will carry out their plan. Nor is it against public policy for two or more stockholders to agree upon a course of corporate action, or upon the officers whom they will elect, and they may do this either by themselves, or through their proxies, or they may unite in the appointment of a single proxy to effect their purpose. Any plan of procedure they may agree upon implies a previous comparison of views, and there is nothing illegal in an agreement to be bound by the will of the majority as to the means by which the result shall be reached. If they are in accord as to the ultimate purpose, it is but reasonable that the will of the majority should prevail as to the mode by which it may be accomplished.

It would not be an illegal agreement if articles of a partnership should provide that stock in a corporation owned by the partnership, though standing in the individual names of the partners, should be

voted by one of its members, and it is no more against public policy for such an agreement to be entered into between stockholders whose interests in the stock are separate than where their interests are joint. Viewed from considerations of public policy merely, it is immaterial whether such an agreement is made by the members of an existing partnership, which owns the shares, or in pursuance of an agreement by two or more persons to form a partnership for their purchase, or to purchase them for their joint account, or as one of the terms of an agreement for their purchase, by persons who contemplate no relation to each other further than that of owning stock in the same corporation. Such agreement would, in any case, be outside of the corporation and disconnected with the interest of every other stockholder, and, in either case, the same rules would control. Whether such an agreement is illegal, so that any action or vote under it can be set aside, or is of such a character that it will not be enforced, will depend upon the object with which it is made, or the acts that are done under it, and will be governed by other rules of law. Mr. Beach, in his treatise on Corporations, section 304, says: "The owners of shares may enter into agreements as between themselves to elect the officers of the company, and to manage its affairs as they or a majority of them shall determine, and it is held that agreements of that character are not illegal nor void as against public policy; for, as was said by the court in a leading case, their interests are identical with the interests of the minority of shareholders." The authority thus referred to is *Faulds v. Yates*, 57 Ill. 416, 11 Am. Rep. 24. In that case Faulds was the owner of a majority of the shares of stock in a corporation, and entered into an agreement with the defendants in the nature of a partnership for the working of a mine, and for the purchase by the defendants from him of two-thirds of his stock. It was provided in the agreement between them that they would elect the directors of the company; that they would determine among themselves as to the officers and management of the company; and that, if they could not agree, they would ballot among themselves for the directors and officers, and that the majority should rule, and their vote be cast as a unit so as to control the election. In an action for a dissolution and accounting of their partnership, it was contended that this portion of the agreement was void as against public policy, and was invalid for the reason that it was in conflict with the interests of the other stockholders. The court, however, held otherwise, using the following language: "There was nothing unlawful in it. There was nothing which necessarily affected the rights and interests of the minority. Three persons owning a majority of the stock had the unquestioned right to combine, and thus secure the board of directors and the management of the property. If one man owned a majority of the stock, he surely had the right to select the agents for its honest management."

In *Hey v. Dolphin*, 92 Hun 230, the parties were jointly interested in certain shares of stock which had been issued to them in a single certificate, and it was agreed between them that the stock should not

be sold, or in any manner disposed of, or the certificates surrendered, for a period of ten years, without their joint consent in writing, but should remain as first issued, "for the purpose of enabling the said parties of the first part to prevent the control and management of the company from passing over to persons who might be less qualified or less disposed to make the business of the said company a success and its stock valuable." By the same agreement Dolphin was appointed a proxy to vote the whole of said shares at all elections, and the proxy was made irrevocable for ten years unless sooner revoked by joint consent. In an action brought for the purpose of having the agreement declared void, and that there be issued to the plaintiff certificates for one-half of the shares, the court held that the agreement was not void or against public policy, saying: "The object and purpose of the arrangement, as stated in the contract, is not of itself vicious, but rather the contrary. This is not a case where, as in some of the cases cited by the respondent, there is a combination of stockholders for the special benefit of some party, or where the power to cast the vote is in a party having no beneficial interest. The arrangement purported to be for the benefit of all the stockholders, and the attorney was one of the parties beneficially interested. It will hardly be claimed that a majority of stockholders may not combine to control an election of directors." See, also, *Havemeyer v. Havemeyer*, 11 Jones & S. (43 N. Y. S.) 506; *Brown v. Pacific Mail S. S. Co.*, 5 Blatchf. 525.

In cases of "voting trusts," where the owners of stock transfer the shares to trustees, with authority to vote at election according to the direction of a majority of those holding trust certificates, and the only consideration for such transfer and agreement is the mutual promises of the several stockholders, it has been held that any stockholder may revoke his agreement and withdraw his stock at will; and it is also held that stockholders, who become such after an agreement of this nature is entered into, are not bound by its terms, but will hold their shares freed from the limitations of the agreement. *Fisher v. Bush*, 35 Hun 641; *Woodruff v. Dubuque, etc., Co.*, 30 Fed. Rep. 91; *Brown v. Pacific Mail S. S. Co.*, 5 Blatchf. 525; *Griffith v. Jewett*, 15 Week. Law Bull. 419. In *Moses v. Scott*, 84 Ala. 608, certain stockholders had formed a voting trust, and placed their stock in the hands of four trustees, with power to vote the stock as a unit at all meetings, as three of them should think best, or, if they failed to agree, as three-fourths of the stock represented should determine, and had agreed not to sell their stock so pooled for three years. There was no consideration for this agreement other than the mutual promise of the several stockholders; and, while the court refused to enforce the agreement concerning the sale, upon the ground that it was in restraint of the free alienation of property, it said: "We can not say there is anything *per se* illegal in an agreement entered into by and between certain stockholders in a joint stock company by which they promise to vote together as a unit in all matters pertaining to the government of the corporation. Each member has the clear right to cast his ballot as he pleases, wisely or unwisely, and no other



stockholder can control his conduct or gainsay his discretion, and it can make no difference if several stockholders uniformly vote together, or so vote in obedience to a prior agreement that they will do so. The vote, when cast, is but the expressed wish of the stockholder, or at least must be so regarded, and no other stockholder can be supposed to be injured thereby. To hold otherwise would greatly abridge the voter's right to cast his ballot as he pleased."

The agreement in question can not be regarded as illegal by reason of being in restraint of trade. The rule invalidating contracts in restraint of trade does not include every contract of an individual by which his right to dispose of his property is limited or restrained. Section 1673 of the Civil Code makes void every contract by which one is restrained from "exercising a lawful profession, trade, or business," except in certain instances. But this is far different from a contract limiting his right to dispose of a particular piece of property, except upon certain conditions. As the owner of property has the right to withhold it from sale, he can also, at the time of its sale, impose conditions upon its use without violating any rule of public policy, and there is nothing inconsistent with public policy for two or more persons, who contemplate purchasing certain property, to agree with each other, as a condition of the purchase, that neither will dispose of his share within a limited period, or for less than a fixed sum, or except upon certain limitations. They have the same right to contract with reference to the terms under which they will hold or dispose of the property after it shall have been purchased, as they have to agree upon any other terms upon which the purchase shall be made, and they no more violate a rule of public policy in making such agreement a consideration of their purchase than would two or more partners who should purchase property for partnership purposes, and agree that it should not be disposed of unless their vendee would assent to certain conditions regarding its use. These terms enter into, and form a part of, the consideration for the agreement to purchase, and are as binding and enforceable as any other terms of the agreement. *New England Trust Co. v. Abbott*, 162 Mass. 148; *Hodge v. Sloan*, 107 N. Y. 244, 1 Am. St. Rep. 816; *Williams v. Montgomery*, 148 N. Y. 519; *Matthews v. Associated Press, etc.*, 136 N. Y. 333, 32 Am. St. Rep. 741. The contract in *Fisher v. Bush*, 35 Hun 641, was held to be invalid for want of any other consideration than the mutual promise of the parties; but it was said in that case: "If these parties and their associates were the promoters of this corporation, then, doubtless, they could have entered into a valid agreement regulating a sale of the same, and requiring the owners to hold them from market for a reasonable and definite period of time, and thus forbidding a sale by either of his interests to one against whom his associates might have a reasonable objection. *Moffatt v. Farquhar*, 7 Ch. Div. 591; reported in 23 Moak Eng. Rep. 731. A stipulation of that character would not be illegal as against public policy, as it would be simply a provision assented to by all that the newcomer into the business transaction should be with the approval of the other joint owners."



Neither is it illegal or against public policy to separate the voting power of the stock from its ownership. The statute authorizes the stockholder to vote by proxy; and it was held in *People's Bank v. Superior Court*, 104 Cal. 649, 43 Am. St. Rep. 147, that a by-law restricting the selection of proxies to stockholders was invalid; that the statute places no limitation upon the right of selection, and that a stockholder may appoint as his proxy one who is an entire stranger to the corporation. The right to appear by proxy implies of itself that the voting power may be separated from the ownership of the stock, and, unless the authority of the proxy is limited by the terms of his appointment, he is necessarily required to use his own discretion in any vote that he gives. Being the agent of the stockholder, he is required to exercise this discretion in behalf of his principal; but he is at liberty to use his own discretion as to the means by which his principal's interest will be best subserved. The cases in which it has been said that the stockholder could not divest himself of the voting power of his stock, and that it should not be separated from the ownership of the stock, were cases which involved either the sufficiency of the agreement by which the voting power was transferred, or the validity of the purpose for which the power was to be exercised. The proxy must exercise a discretion of the same nature as that which the stockholder is authorized to exercise, and an authority to do otherwise would be invalid; but the authority to exercise a discretion differs from an authority to perform a particular act. Under an appointment without words of limitation the proxy may act against the interests of the stockholder, or even against the interests of the corporation, and the corporation, as well as the stockholder, will be bound by his act as fully as if the stockholder had acted in person, while, if the authority had been directed in terms to that act, it might have been invalid. The distinction is that between an unlawful exercise of a lawful power and the attempt to authorize the exercise of an unlawful power. The question has been presented in cases of voting trusts, but an examination of these cases will show that the question has arisen either when the authority was expressly given to carry out some illegal purpose, or when, having been given without any consideration, though purporting to be for a definite term, subsequent owners of the stock have sought to revoke it before the expiration of the term: *Shepaug Voting Trust Cases*, 60 Conn. 553, sometimes reported under the name of *Bostwick v. Chapman*; *White v. Thomas Inflatable Tire Co.*, 52 N. J. Eq. 178.

We have been cited to no instance where the purpose of a proxy given upon a sufficient consideration was lawful, and the person by whom the proxy was created continued to be the owner of the stock, in which the agreement has been held invalid. The stockholder can not separate the voting power from his stock by selling his right to vote for a consideration personal to himself alone, any more than he could agree for the same consideration to cast the vote himself, and an agreement with others to appoint a proxy upon the same considerations would be equally invalid. In *Cone v. Russell*, 48 N. J. Eq.

208, an agreement by the purchaser of stock to give to other stockholders his irrevocable proxy for the purpose of securing and maintaining the control of the company was held invalid, for the reason that it was one of the terms of the agreement that the directors, to be elected under its provisions, should employ the one giving the proxy at a fixed salary during its existence. Such an agreement was held to operate as an inducement to elect directors who would not act disinterestedly for the benefit of all of the stockholders, but rather to promote the interest of the parties to the agreement alone, and was therefore void, as being against public policy. The court, however, said: "This conclusion does not reach so far as to necessarily forbid all pooling or combining of stock, where the object is to carry out a particular policy with the view to promote the best interests of all the stockholders." It was upon this principle that the agreements in *Hafer v. New York, etc., R. Co.*, 14 Week. Law Bull. 68; *Guernsey v. Cook*, 120 Mass. 501; and *Fennessy v. Ross*, 5 N. Y. Sup. Ct. App. Div. 342, were held invalid. The same principle was declared in *Gage v. Fisher*, 5 N. Dak. 297. In *Mobile, etc., R. Co. v. Nicholas*, 98 Ala. 92, the court held that there was nothing illegal or contrary to public policy in separating the voting power of the stock from its ownership, saying: "Where a proxy is duly constituted, and the power of the appointment is without limitation, the vote cast by the proxy binds the stockholder, whether exercised in behalf of his interest or not, to the same extent as if the vote had been cast by the stockholder in person. The invalidity of acts of this character by a proxy, rightly understood, is not made to rest upon the ground that there has been a separation of the voting power from the stockholders, but because of the unlawful purpose for which the proxy was appointed, or the unlawful end attempted to be effected by the exercise of the voting power."

*Reversed.*

Van Fleet, McFarland, and Henshaw, JJ., concurred; Beatty, C. J., dissented.

*Note. Accord:* 1900, *Chapman v. Bates*, 61 N. J. Eq. 658, 47 Atl. Rep. 638, 13 Am. & E. C. C. (N. S.) 319, 88 Am. St. R. 459.

See notes 56 Am. St. Rep. 138, 153, and 6 Am. & E. C. C. (N. S.) 229-233.

By act of April 16, 1901 (ch. 355, section 20, amending ch. 35 of the General Corporation Law), New York has provided for voting trusts as follows: "A stockholder may, by agreement in writing, transfer his stock to any person or persons for the purpose of vesting in him or them the right to vote thereon for a time not exceeding five years, upon terms and conditions stated, pursuant to which such person or persons shall act; every other stockholder, upon his request therefor may, by a like agreement in writing also transfer his stock to the same person or persons and thereupon may participate in the terms, conditions and privileges of such agreement; the certificates of stock so transferred shall be surrendered and canceled and certificates therefor issued to such transferee or transferees in which it shall appear that they are issued pursuant to such agreement, and in the entry of such transferee or transferees as owners of such stock in the proper books of said corporation that fact shall also be noted and thereupon he or they may vote upon the stock so transferred during the time in such agreement specified; a duplicate of every such agreement shall be filed in the office of the corporation where its principal business is transacted and be open to the inspection of any stockholder, daily, during business hours. No member of a corporation shall sell his vote or issue a proxy to vote to any person for any sum of money or any thing of value."

**Sec. 542. 3. Right to dividends.**  
**(a) Definition.**

**MOBILE AND OHIO RAILROAD COMPANY v. TENNESSEE.<sup>1</sup>**

**1894. IN THE SUPREME COURT OF THE UNITED STATES. 153 U. S. Rep. 486-509.**

[Error to the supreme court of Tennessee. In 1848 the state of Tennessee chartered the railroad company, without reserving the right to amend or repeal the charter, which provided that the capital stock of the corporation should forever be exempt from taxation, the road with all its fixtures and appurtenances should be exempt from taxation for twenty-five years from its completion, and "no tax shall ever be laid on said road or its fixtures which will reduce the dividends below eight per cent." After the twenty-five years' exemption had expired certain taxes were assessed against the property of the company, which were alleged to be in excess of the rightful amount, because the company had not earned dividends to the extent of eight per cent. The supreme court adjudged the exemption to be vague and uncertain and held the taxes to be valid, and this (among other things) is the error assigned.]

MR. JUSTICE JACKSON. \* \* \* This last ground on which the court rested its judgment is manifestly unsound, for the clause in question, that "no tax shall ever be laid on said road or its fixtures which will reduce the dividends below eight per cent.," is clearly not so incapable of any reasonable construction as to be void. On the contrary, its terms are plain and unambiguous. The only matter involving construction or interpretation is the meaning to be attached to the term "dividend." It admits of no question that the word "dividend" mentioned therein has reference to dividends on the capital stock of the company held and owned by its shareholders. The term "dividend," in its technical as well as in its ordinary acceptance, means that portion of its profits which the corporation, by its directory, sets apart for ratable division among its shareholders. *Lockhart v. Van Alstyne*, 31 Michigan 76; *Boone on Corporations*, section 125.

In the present case it appears that the maximum capital stock authorized by the charter was \$10,000,000, and that the stock actually issued by the company, at various times during the construction of the road, and outstanding, amounted to the sum of \$5,320,600, which, together with the company's bonded indebtedness, fairly represented the cost of building and completing the road. The amount of stock being fixed, it was a matter of mere calculation as to when the profits from net earnings would be sufficient to meet the designated dividend.

<sup>1</sup> Statement abridged. Only that part of the opinion relating to the single point is given. Opinion of Fuller, C. J. (Gray, Brewer and Shiras, JJ., concurring), dissenting upon the ground that exemption violated the constitution of Tennessee, is omitted.

Again, dividends can be rightfully paid only out of profits. Corporations are liable to be enjoined by shareholders or creditors from making a distribution, in dividends, of capital. Taylor on Corporations, section 565, and authorities cited.

The term "profits," out of which dividends alone can properly be declared, denotes what remains after defraying every expense, including loans falling due, as well as the interest on such loans. Correy v. Londonderry Railway Co., 29 Beav. 263.

The net earnings of corporations out of which profits are distributable in dividends are thus defined in *St. John v. Erie Railway Co.*, 10 Blatchford 279: "Net earnings are properly the gross receipts less the expenses of operating the road to earn such receipts. Interest on debts is paid out of what thus remains—that is, out of the net earnings. Many other liabilities are paid out of the net earnings. When all liabilities are paid, either out of the gross receipts or out of the net earnings, the remainder is the profit of the shareholders, to go toward dividends, which, in that way, are paid out of the net earnings." This case was affirmed by this court, 22 Wall. 136.

In *New York, Lake Erie and Western Railroad v. Nickals*, 119 U. S. 296, 308, the same general rule that shareholders are entitled only to dividends out of the net earnings derived from the operations of the company is reaffirmed.

It must be assumed that the legislature of Tennessee used the term "dividends," in the exemption clause under consideration, in the general sense indicated, and had reference to that portion of the net earnings of the company which legitimately constituted profits and could be rightfully apportioned or distributed among shareholders. There is no difficulty in ascertaining the amount of such profits in any year, and the stock actually issued being fixed, it is hard to understand how it could be held that the exemption clause was void and unenforceable for want of certainty. The law regards that as certain which is capable of being ascertained and definitely fixed. The state can not complain that no method has been provided for ascertaining the amount of profits applicable to the payment of the designated dividends. That is a matter purely of administration, which does not touch in any way the validity of the contract embodied in the exemption clause.

It is stated on behalf of the defendants in error that the company earned for the years in question profits more than sufficient to pay eight per cent. dividends, if the interest on its bonded indebtedness was not chargeable against the earnings. This point was not passed upon by the court below, and, if the fact be as stated, it could not avail the defendants in error, for the payment of the annually accruing interest on the bonded debt of the railroad company was a proper charge against the net earnings, to be paid before dividends could be declared thereon. Mr. Justice Bradley, in *Union Pacific Railroad v. United States*, 99 U. S. 402, 422, declared that interest on the bonded indebtedness of the company, like other current expenses, was payable out of the net earnings before dividends could be distributed to the stockholders.

In *Belfast and Moosehead Lake Railway v. Belfast*, 77 Maine 445, it was directly adjudged that the interest on the bonded debt is payable out of the net earnings before dividends can properly be declared.

In *Corry v. Londonderry and Enniskillen Railway*, 29 Beav. 263, 272, 274, Sir John Romilly, Master of the Rolls, in discussing this subject, while admitting that the funded indebtedness of a corporation was not properly payable out of profits before there could be a division thereof, held that any and all debts which had been incurred, and which were due from the company and ought to have been paid, and would have been paid at the time had the corporation possessed the necessary funds for that purpose, constituted proper deductions from the earnings before the profits properly distributable could be ascertained.

The further claim is made in the brief, although not insisted upon in argument, that if the earnings of the company were insufficient upon which to declare a dividend, the exemption clause had no operation, because there would be no reduction of dividends. In other words, that the property of the company was taxable during all the years that it could not declare any dividends. This suggestion is wanting in plausibility and needs no further consideration, for if the exemption clause has any meaning, purpose, or validity whatever, this theory would utterly destroy it, as the company would be taxable when it made no profits, and get the benefit of the exemption only when profits to a certain amount were realized. \* \* \*

*Reversed.*

*Note.* See, 1900, *Larwill v. Burke*, 19 Ohio C. C. 513; 1899, *Rose v. Barclay*, 191 Pa. St. 594, 45 L. R. A. 392.

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**Sec. 543.** (b) Out of what, dividends may be declared; provision for payment of permanent debts.

**BELFAST AND MOOSEHEAD LAKE RAILROAD COMPANY v. CITY OF BELFAST.<sup>1</sup>**

1885. IN THE SUPREME JUDICIAL COURT OF MAINE. 77 Me. Rep. 445-457.

[The railroad company was incorporated in 1867, the charter authorizing the issuing of preferred and non-preferred stock. At the organization, and before subscriptions were received, a by-law provided that dividends on preferred stock shall first be made semi-annually from the net earnings, not exceeding 6 per cent. per annum, after which, if a surplus remain, a dividend up to a like per cent. shall be made on the non-preferred stock,—and if any surplus should then remain, a *pro rata* dividend should be made on all the stock.

<sup>1</sup> Statement abridged; arguments and part of opinion omitted.



The original policy was to build the road altogether from the subscription to the stock, amounting to \$648,100 paid in full, without borrowing money. This being found to be impracticable, without the dissent of any one, in 1870 a bonded indebtedness to the amount of \$150,000, to run twenty years, with interest payable semi-annually, was created and secured by mortgage; also the sum of \$101,900 was borrowed of the city of Belfast, the principal stockholder, for which the company's note was given, payable with annual interest in 1885; and in addition a miscellaneous floating debt of about \$150,000 more was incurred. In 1870 the company leased its road for fifty years to the Maine Central R. Co., at an annual rental of \$36,000, payable half yearly. By means of this rental, at the time this suit was pending in 1882, the company had paid off all the floating debt, but owed the city of Belfast \$87,900, and its \$150,000 bonds maturing in 1890, and had a sinking fund of \$26,033, and would have \$10,863 remaining after paying interest then due upon the note and bonds. A dispute arose between the two classes of stockholders as to whether the preferred stockholders were entitled to any dividend out of this \$10,863, and this bill was filed to determine this question.]

PETERS, C. J. \* \* \* Upon these facts, affected somewhat by other incidental facts which will appear, the position is taken, by the counsel for the city, that the preferred stockholders, as between themselves and the common stockholders, are not entitled to any dividends until the entire indebtedness of the company is paid; that, inasmuch as the subscriptions to both classes of stock were made when the declared policy of the corporation was not to create a corporate debt, with the then full expectation by all parties that none would be created, and inasmuch as the debts were unavoidably incurred for the common benefit of all stockholders, the burden of removing the debts should be borne by all the shares alike, and not fall exclusively upon the common stock. The city contends that the favored class were to be preferred stockholders only upon the condition that there should be no debts; that there was an implied contract to that effect; or, if not a contract, that such a result is demanded by a natural and necessary equity which flows from the relation of the parties.

We think such a position is not tenable, as a claim, either in law or equity. The subscribers must have known, if they reflected at all about it, that corporate indebtedness might become necessary in spite of the strongest pledges to the contrary. In fact, the twelfth by-law implies that debts might be incurred. It is said that the holders of the preferred stock favored a bonded debt. But it was not upon any condition that they should surrender any right thereby. All stockholders favored it. There was no voice against it. If A has the first and B the second mortgage on a vessel, taking their securities at the same time, anticipating no disaster to the vessel, and a disaster comes, requiring a bottomry bond upon the property, the payment of such bond is not a burden common to the two mortgages. The illustration may not be inapt.



The main question of the case is whether, in November, 1882, the financial condition of the company was such that the preferred stockholder was then legally entitled to a dividend.

No such claim could have been made upon the ground that he is a creditor of the company; he is not such. Preferred stockholders, ordinarily, are not creditors. That is the common doctrine of the authorities. *Chaffee v. Railroad*, 55 Vt. 110, and numerous cases cited.

It was not intended in the present instance to guarantee a dividend. If a dividend is prevented in any one year by a deficit of earnings, it can not be made up from the earnings of succeeding years. A six per centum dividend is not assured by the contract of subscription. It may be less. The implication of the by-law is clear that there is to be no surplus of profits to be carried from one year to another. The net earnings are to be wholly distributed each year. The language of the by-law is really the language of the general law. It promises dividends whenever there are net earnings from which to make them.

The difficulty is in deciding what should be considered as net earnings; that is, net earnings such as are applicable to dividends. In a general sense, net earnings are the gross receipts less the expenses of operating the road to earn such receipts. But several kinds of charges must first come out of net earnings before dividends are declared. The creditor comes in for consideration before the stockholder. The property of a corporation is a trust fund pledged for the payment of its debts. Therefore, if there is a bonded, funded, permanent or standing debt, the interest on it must be reckoned out of net earnings. If there is a floating debt, which is not wise and prudent to place in the form of a funded debt, or to postpone for later payment, that should also be paid. If the financial situation of the company is such as to render it expedient to commence or continue the scheme of a sinking fund for the extinguishment of the company's indebtedness some day or other, an annual contribution out of the net earnings for that purpose would be reasonable. These deductions made from the net earnings, the balance will be the profits of the company distributable among stockholders. In *Pierce on Railroads*, 125, it is said: "The dividends on preferred stock are payable only out of net earnings which are applicable to the payment of dividends, and the interest on the bonded or other interest-bearing debt, even though contracted after the issue of the preferred stock, and the rent upon leases made after the issue thereof, shall be first paid." The definition of net earnings above given is supported by the authorities. *Chaffee v. Railroad*, *supra*, and cases cited; *Taft v. Railroad*, 8 R. I. 310; *St. John v. Erie Railway Co.*, 10 Blatchf. 271, s. c. 22 Wall. 136; *Union Pacific R. v. United States*, 99 U. S. 402.

But it does not necessarily follow that debts should be first wholly paid before a declaration of dividends, merely because they are of a floating character. It may be that it would be reasonable and proper

to convert such liabilities into a funded debt. Nor does it follow that all of the income of a road may not be needed for the payment of its funded or standing debt. All depends upon the financial resources and abilities of the corporation and the prospects of its road. Where it can be safely done, considering the interests of the company's creditors and of all persons concerned, the general practice of railroads has been to include with expenses chargeable to capital those which are incurred in the original construction of the road. And the courts have admitted the reasonableness of the rule. The idea is that the capital paid in and the capital borrowed unitedly produce the earnings, and that a share of the same should be accorded to each. The distinction between expenses for construction and ordinary expenses is maintained in the leading cases. See cases *supra*; Corry v. Railroad Co., 29 Beav. 263; Bouch v. Railroad Co., L. R. 4 Ex. Div. 133; Mills v. Northern R. Co., L. R. 5. Ch. App. 621; Pierce Railroad Co., 125, and cases in notes. In the case last cited (Mills v. Railroad Co.) Lord Hatherly, L. C., said: "Mr. Dickinson started a very curious theory, which, I apprehend, never found its way into any mercantile arrangement—that there never can be any available income, or any profit, so long as there is any debt remaining unpaid. If that be so, I suppose there is hardly a railway in the kingdom which could pay any dividends at all to their stockholders. The whole scheme of railway arrangements, as I understand them, has always been this, that the companies are authorized to raise part of their capital by shares, and to raise further capital by means of borrowing to the amount of one-third of the whole capital."

In the case before us the company has no ordinary expenses beyond a small sum necessary to support its organization. What sum, then, shall be taken from its earnings to be paid to, or be set aside for, its creditors? One side says, all its earnings; and the other side says, set aside annually a sum which with accumulations will insure the payment of all the corporate indebtedness by 1920, the date of the end of the lease.

As a general rule, the officers of a corporation are the sole judges as to the propriety of declaring dividends, and the courts will not interfere with a proper exercise of their discretion. The company usually establishes its financial policy for itself. Yet, when the right to a dividend is clear, and there are funds from which it can properly be made, a court of equity will interfere to compel the company to declare it. Directors are not allowed to use their power illegally, wantonly or oppressively. See cases *supra*. Also Williston v. Railroad Co., 13 Allen 400; Boardman v. Railroad, 84 N. Y. 157; Jermain v. Railroad, 91 N. Y. 483. In the present case we are by all the parties invited to accept jurisdiction; the facts are agreed; and all technicalities are waived. We may adopt such a standard of judgment, in determining the question, as we think would and should regulate the exercise of the sound discretion of directors, acting in good faith, in deciding the same question. Barnard v. Railroad, 7 Allen 512, 521.

Two facts are very much relied upon by the preferred stockholders as favoring their contention. One is an amendment to the eighteenth by-law, passed by the corporation in July, 1879, which is this: "The words 'net earnings,' as used in this section (by-laws), shall be construed to mean all the surplus remaining after the payment of the necessary incidental charges and expenses, the interest on the mortgage and funded debt, and such provision for payment of the maturing obligations of the corporation as in the judgment of the directors may be necessary; and for this latter purpose, the directors shall establish a sinking fund, to be maintained in such form and manner as they may deem for the best interest and safety of the corporation." This in 1882 was repealed.

The other fact is, that when the subscribers for preferred stock, not including the city of Belfast, paid their subscriptions, not being under strict legal obligation to do so, they were induced to make the payment by the corporation securing to them semi-annual six per cent. dividends, and the final payment of their stock, by means of bonds with coupons, covered by a second mortgage on the road—which bonds and coupons were taken as collateral to the stock and dividends. This mortgage was, however, afterwards canceled for prudential reasons and with the consent of all parties interested.

The counsel for the city contends that those proceedings, afterwards annulled, are to have no more effect upon the present question than if never existing. We do not concur in that position fully. We think, as admissions, as expressions of a policy inaugurated and for a long time acted upon by the company, they serve to impress upon the claim of the preferred stockholders at least an appearance of equity.

After a full consideration of all the evidence and theories presented to us, we incline to the conclusion that the directors would be justified in refusing to make any further dividends until enough money has been accumulated, from the rent and the sinking fund, to pay the note to the city of Belfast. When the company receives from its lessee the rent due in May, 1885, it will have money enough with which to pay the note, and a few thousands more.

There are quite significant reasons for drawing a line at the point indicated. The note may well be considered as given for temporary purposes in anticipation of rents receivable. The company really has no credit which would enable it to renew the note, inasmuch as its outstanding mortgage covers all its property. It looks as if the note represents a sort of forced loan from the city, and as given for money that could not have been obtained from any other source, the city borrowing it for the purpose of loaning it, being induced to do so on account of her immense interests involved as a shareholder. She now asks for her money, being unwilling to renew the note, and she is entitled to its payment. The corporation would find it difficult to borrow it elsewhere. It would look like borrowing money to pay dividends.

There are much more forcible reasons for the corporation to hold its moneyed resources in reserve until the note to the city is paid than

there are for afterwards continuing the same policy until the debt of \$150,000, due in 1890, is paid. The two debts stand upon a different footing. The latter is a bonded mortgage debt, no part of which is due, and which undoubtedly can be wholly or partially renewed when it becomes due. It fairly represents a part of the original cost of constructing the road. The company has thirty-five years or more of assured rent with which it can pay the amount. It has no other debt, after paying the note to the city, present or prospective. It has evidently regarded that amount as a permanent or standing interest-bearing indebtedness. To renew the mortgage or a portion of it, when it becomes due, we think would be regarded, in a mercantile sense, as a reasonable, safe and conservative calculation. The preferred stockholders were to have semi-annual dividends, if earned. They should have them, if they can be declared without the least peril to the company or any of its creditors. Belfast herself owns all the preferred stock but about \$100,000, there being over \$380,000 of it in all. We think that, after the note is paid, the directors may well make some reasonable provision for the final extinguishment of the mortgage debt by reserving therefor a portion of the rent to be received under the lease, and divide the balance among stockholders.

A scheme could be perfected by an expert in such matters, by which there may be a yearly contribution to a sinking fund, which, with its accumulations, will discharge all the indebtedness within a reasonable time before the lease expires, and pay more or less dividends in the meantime; or, before or by the year 1890, a new bond could be put upon the market, a certain portion to be paid annually, such portion to be designated by lot, or in some other way which might accomplish the same end as effectually.

We need not be minute in any details, inasmuch as our observations in this respect are not intended as anything more than illustration or argument. The bill commits to us power over only the sum of \$10,863, which came from a payment of rent in November, 1882, and that sum, as already indicated, may properly be applied by the company upon its debt.

Under the circumstances of the case, no costs to be recovered by any party.

*Decree according to the opinion.*

Walton, Virgin, Libbey, Foster and Haskell, JJ., concurred.

*Note.* See, 1866, Taft v. H. P. & F. R. Co., 8 R. I. 310; 1869, In re Mercantile Trading Co., Stringer's Case, L. R. 4 Ch. App. 475; 1874, St. John v. Erie R. Co., 22 Wall. (U. S.) 136; 1875, Lockhart v. Van Alstyne, 31 Mich. 76; 1881, Boardman v. L. S. & M. S. R. Co., 84 N. Y. 157; 1882, Chaffee v. Rutland R. Co., 55 Vt. 110; 1882, Guinness v. Land Corp., 22 Ch. D. 349; 1899, Burden v. Burden, 159 N. Y. 287; 1899, In re Nat'l Bank, 68 L. J. Ch. 634, 81 L. T. R. (N. S.) 363; 1900, Moxham v. Grant, 69 L. J. Q. B. 97, 81 L. T. R. (N. S.) 431.

It is said directors must set aside a fund to replace depreciation of property before a dividend is declared (Davison v. Gillies, L. R. 16 Ch. Div. 347, note); and also for cost of repairs, and for constant wear and tear, etc. (Whittaker v. Amwell Nat'l Bank, 52 N. J. Eq. 400); but this is denied (Bolton v. Natal Co., 65 L. T. Rep. (N. S.) 786); and an exception is conceded

to exist in the case of mining and other companies, the profits from which are made by using up the property owned (*Excelsior, etc., Co. v. Pierce*, 90 Cal. 131). If creditors' rights are not affected, and no shareholders dissent, the corporate capital may be distributed (*People v. Barker*, 141 N. Y. 251); but stockholders to whom all the assets of the corporation have been distributed can be compelled to refund, when necessary to pay creditors (1898, *Grant v. Southern Contract Co.*, 20 Ky. L. Rep. 960, 47 S. W. Rep. 1091). See, *contra*, p. 1981, *infra*.

**Sec. 544. Same. (c) Stock dividends.**

**WILLIAMS, RESPONDENT, v. THE WESTERN UNION TELEGRAPH COMPANY, ETC., APPELLANT.<sup>1</sup>**

1883. IN THE COURT OF APPEALS OF NEW YORK. 93 N. Y. Rep. 162-196.

[Appeal from order of general term of supreme court. The directors of defendant, the W. U. T. Co., entered into a contract with two other telegraph companies, each operating lines nearly parallel, but extending to places not reached by the lines of either of the other companies, by which contract said defendant agreed to purchase and the other companies to convey to it all their property, rights, privileges and franchises. The capital stock of the W. U. T. Co. was at that time \$41,073,410. It was agreed that it should take steps to increase its capital to \$80,000,000, the addition to be used as follows: \$15,526,590 as a dividend to its then stockholders, and \$23,400,000 in payment for the property and interests so transferred. The agreement was approved at a meeting of the stockholders of the W. U. T. Co., and the increase of its capital stock duly authorized, as prescribed by the acts providing for the incorporation of telegraph companies. (Chapter 265, laws of 1848, as amended by chapter 98, laws of 1851; chapter 471, laws of 1853; chapter 425, laws of 1862; chapter 568, laws of 1870; chapter 319, laws of 1875.) In an action brought by a stockholder to test the validity, and restrain the carrying out, of said agreement, it was found that the value of the property, rights and interests purchased was equal to the par value of the stock to be paid therefor, and that the W. U. T. Co. owned and possessed, at the time, over and above its then capital, property equal in value to the amount of the stock dividend; that the object of the agreement was to extend and perfect the telegraph systems established by the companies, and no fraud or collusion was found.]

EARL, J. \* \* \* The stock dividend was claimed to be in violation of chapter 18, part 1, title 4, section 2 of the Revised Statutes, which provides as follows: "It shall not be lawful for the directors or managers of any incorporated company in this state to make dividends excepting from the surplus profits arising from the business of such corporation; and it shall not be lawful for the directors of any

<sup>1</sup> Statement taken from syllabus. Arguments and part of opinion upon other points omitted.



such company to divide, withdraw, or in any way pay to the stockholders, or any of them, any part of the capital stock of such company, or to reduce the said capital stock, without the consent of the legislature; and it shall not be lawful for the directors of such company to discount or receive any note or other evidence of debt in payment of any installment actually called in and required to be paid, or any part thereof due or to become due on any stock in the said company; nor shall it be lawful for such directors to receive or discount any note or other evidence of debt with the intent of enabling any stockholder in such company to withdraw any part of the money paid in by him on his stock; and in case of any violation of the provisions of this section the directors, under whose administration the same may happen, except those who may have caused their dissent therefrom to be entered at large on the minutes of the said directors at the time, or were not present when the same did happen, shall, in their individual and private capacities, jointly and severally, be liable to the said corporation and to the creditors thereof, in the event of its dissolution, to the full amount of the capital stock of the said company, so divided, withdrawn, paid out, or reduced, and to the full amount of the notes or other evidences of debt so taken or discounted in payment of any stock, and to the full amount of any notes or evidences of debts so discounted with the intent aforesaid, with legal interest on the said respective sums from the time such liability accrued; and no statute of limitation shall be a bar to any suit at law or in equity against such directors for any sums for which they are made liable by this section: Provided, This section shall not be construed to prevent a division and distribution of the capital stock of such company which shall remain after the payment of all its debts, upon the dissolution of such company, or the expiration of its charter."

This dividend was condemned by the general term of the superior court as a violation of that section. Our attention has been called to no other law forbidding or condemning a stock dividend, and in their allegations against it the counsel for the plaintiff rely mainly upon that section. After reading the numerous opinions that have been submitted to us, and giving careful attention to all that has been said upon the subject, we are unable to perceive that that section has any bearing whatever upon the question we are to determine. The section was taken from the act, chapter 325 of the laws of 1825, which was entitled, "An act to prevent fraudulent bankruptcies of incorporated companies, to facilitate proceedings against them, and for other purposes." It was not part of the original revision, but was incorporated into the Revised Statutes by chapter 20 of the laws of 1828. A careful reading of the section shows that it has reference only to the property capital of a corporation, and not to its share capital. The first clause prohibits dividends of property except from surplus profits. It is further provided that the directors of any corporation shall not divide, withdraw or in any way pay to the stockholders, or any of them, any part of the capital stock of such company, or to reduce the capital stock without the consent of the legislature. These



provisions are intended to prevent the division, distribution, withdrawal and reduction of the property of a corporation below the sum limited in its charter or articles of association for its capital, but not to prevent its increase above that sum. The purpose was to prevent the depletion of the property of the corporation, thereby endangering its solvency. All the other provisions of the section show very clearly that such was the intention. Careful provision was made that the whole amount of capital stock should be paid in, and hence there was a prohibition against receiving a note or other evidence of debt in payment of any installment actually called in and required to be paid; and in case the directors violated any of the provisions of the section they were made individually liable to the corporation and to its creditors, in the event of its dissolution, to the full amount of the capital stock of the company so divided, withdrawn or reduced.

All these provisions show that it was the purpose of the legislature, by means of them, to create a property capital for the corporation, and then to keep that intact so as to secure the solvency of the corporation and its responsibility to its creditors. The "capital stock" in this section does not mean share stock, but it means the property of the corporation contributed by its stockholders or otherwise obtained by it, to the extent required by its charter. While the term "capital stock" is frequently used in a loose and indefinite sense, in this section and in legal phrase generally it means that and no more. In *State v. Morristown Fire Association* (3 Zab. 195), Green, Ch. J., said: "The phrase 'capital stock' is very generally, if not universally, used to designate the amount of capital to be contributed for the purposes of the corporation. The amount thus contributed constitutes the 'capital stock' of the company." In *Burrall v. Bushwick R. Co.* (75 N. Y. 211), Folger, J., defined "capital stock" as "that money or property which is put in a single corporate fund by those who by subscription therefor become members of a corporate body." In *Barry v. Merchants' Exchange Co.* (1 Sandf. Ch. 280), Vice-Chancellor Sandford said: "The capital stock of a corporation is like that of a copartnership or joint-stock company, the amount which the partners or associates put in as their stake in the concern." By loss or misfortune, or misconduct of the managing officers of a corporation, its capital stock may be reduced below the amount limited by its charter; but whatever property it has up to that limit must be regarded as its capital stock. When its property exceeds that limit, then the excess is surplus. Such surplus belongs to the corporation and is a portion of its property, and, in a general sense, may be regarded as a portion of its capital, but in a strictly legal sense it is not a portion of its capital, and is always regarded as surplus profits. The very section we are considering contemplates that there may be a surplus, and that such surplus may be divided. The surplus may be in cash, and then it may be divided in cash; it may be in property, and if the property is so situated that a division thereof among the stockholders is practicable, a dividend in property may be declared, and that may be distributed among stockholders. All such dividends

diminish and deplete the property of the corporation, and that section was designed to prevent dividends of property which tended to deplete the assets of the company below the sum limited in its charter as the amount of its capital stock. But stock dividends never diminish or interfere with the property of a corporation, and hence are not within the purview of that section. After a stock dividend a corporation has just as much property as it had before. It is just as solvent and just as capable of meeting all demands upon it. After such a dividend the aggregate of the stockholders own no more interest in the corporation than before. The whole number of shares before the stock dividend represented the whole property of the corporation, and after the dividend they represent that and no more. A stock dividend does not distribute property, but simply dilutes the shares as they existed before; and hence that section in no way prevented or related to a stock dividend. Such a dividend could be declared by a corporation without violating its letter, its spirit or its purpose. It is, therefore, clear that the directors of the Western Union Telegraph Company did not violate that section by the stock dividend which they declared; and if that dividend was illegal it must be because it was condemned by some other statute, or by some general principle of law or by public policy.

Our attention has been called to no statute, and we know of none in this state, which prohibits a corporation from making a stock dividend. The legislatures in some of the states have, we believe, passed laws prohibiting such dividends, but in this state no such law has been enacted.

There is no public policy which, in all cases, condemns such dividends. Shares having been legally brought into existence may be distributed among the stockholders of a company. By such distribution no harm is done to any person, provided the dividend is not a mere inflation of the stock of the company, with no corresponding values to answer to the stock distributed. It may be that a distribution of stock gratuitously to the stockholders of a company based upon no values, a mere inflation, or, to use a phrase much in vogue, a watering of stock, would be condemned by the law. But when stock has been lawfully created and is held by a corporation, which it has a right to issue for value, then a stock dividend may be made, provided that the stock always represents property. It is conceded that the directors of the Western Union Telegraph Company could have issued this stock for money to be paid into its treasury. It could have issued it for property to be received by it for the purposes of its legitimate business. But here it is found that over and above its capital it possessed property actually worth upwards of \$15,000,000, and we know of no law that is violated, and no public policy that is invaded by issuing to the stockholders stock to represent that amount of property rather than in any mode to divide it up and distribute it among them. If it can issue stock in payment of property to be obtained by it as part of its capital for its legitimate uses, why may it not issue stock to its stockholders in payment for property in

effect purchased of them and added to its permanent capital, and which they relinquish the right to have divided? So long as every dollar of stock issued by a corporation is represented by a dollar of property, no harm can result to individuals or the public from distributing the stock to the stockholders. Here there was no fraud, no conspiracy, no unlawful combination, and we are bound, under the findings of the court at special term, to assume that all this was done in good faith; and we know of no principle of law, no public policy, and no statute that condemns a stock dividend under such circumstances. (Howell v. The Chicago and North Western R. Co., 51 Barb. 378; Jones v. Terre Haute and Richmond R. Co., 57 N. Y. 196; Kenton Furnace, etc., Co. v. McAlpin, 5 Fed. Rep. 743; Attorney-General v. State Bank, 1 D. & B. Eq. Cas. (N. C.) 545; Minot v. Paine, 99 Mass. 101; Rand v. Hubbell, 115 Mass. 471; Brown v. Lehigh Coal and Navigation Co., 49 Pa. St. 270; Commonwealth v. Pittsburgh, Fort Wayne and Chicago R. Co., 74 Pa. St. 83; Terry v. Eagle Lock Co., 47 Conn. 141; Barton's Trust, L. R., 5 Eq. Cas. 239; Mills v. Northern R. of B. A. Co., L. R., 5 Ch. App. 621; Pierce on the Law of Railroads (2d ed.), 123.)

It is true that this dividend largely increases the capital stock of the company, but that is not against the policy of our laws. That can not be against the policy of the law which the law expressly permits. There is no limit to the capital which business corporations in this state may have, and there is no limit in the law beyond which they may not increase their capital. All that can be required in any case is that there shall be an actual capital in property representing the amount of share capital issued. Indeed, so far as the solvency and responsibility of a corporation is concerned, they are increased by a stock dividend where it has a surplus of property to correspond to the amount of shares issued. In such case the surplus property is secured and impounded for the benefit of the creditors of the corporation and for the public, so that thereafter it can never be legally divided, withdrawn or dissipated in any way.

But if it can be conceived that this was a dividend of property within the meaning of the section of the Revised Statutes above set out, then what property did it divide? Not any portion of the capital of the company; that remained intact. After subtracting the dividend there remained to the company the full amount of its prior capital stock, to wit: Property to the value of \$41,073,410. Such is the finding of the trial court, and that can not here be disputed. The company had made surplus earnings which it could have divided, but instead of dividing them it had invested them in property to facilitate and enlarge its business; and such property was found to be worth \$15,526,590. That sum constituted its surplus. It was commingled with the other property of the company and used for corporate purposes. But it was not beyond the reach of the dividend-making power of the directors. They could reclaim it for division among the stockholders, and, if practicable, convert it into cash for that purpose. They could borrow money on the faith of it and divide that. They

could issue to the stockholders certificates of indebtedness, redeemable in the future, representing their respective interests in such surplus, thus, in effect, borrowing the same of the stockholders. Desiring to use the surplus and add it to the permanent capital of the company, and having lawfully created shares of stock, they could issue to the stockholders such shares to represent their respective interests in such surplus. In doing these things no law would be violated, the capital would be kept intact, and no stockholders or creditors would have any legal right to complain. All this, however, depends upon the finding of the trial court that the surplus is equal to the dividend. That finding is not open to criticism here. It was not disturbed at the general term and therefore concludes us.

When a corporation has a surplus, whether a dividend shall be made, and if made, how much it shall be, and when and where it shall be payable, rests in the fair and honest discretion of the directors uncontrollable by the courts. (*Brown v. Monmouthshire Ry. & C. Co.*, 4 Eng. L. & Eq. 113; *Rex v. Bank of England*, 2 Barn. & Ald. 620; *Jackson's Admrs. v. Newark Plankroad Co.*, 31 N. J. Law 277; *Ely v. Sprague*, Clark's Ch. 351.) There is no statute which requires dividends in telegraph companies or in companies generally to be made in cash. Whether they shall be made in cash or property must also rest in the discretion of the directors. There is no rule of law or reason founded upon public policy which condemns a property dividend. The directors could convert the property into cash before a dividend and divide that. So the stockholders can take the property divided to them and sell it, and thus realize the cash. Within the domain of law it can make no material difference which course is pursued. If, however, a dividend be made payable in cash, or payable generally, the corporation becomes a debtor, and must discharge such debt, as it is bound to discharge all its other debts, in lawful currency. It is true that a stockholder can not be compelled to receive property divided to him. So he can not be compelled to take a cash dividend. In case of his refusal to take a cash dividend, the corporation may retain it for him until he shall demand it. In case he shall refuse to take a property dividend, the corporation may retain it and hold it in trust for him, or possibly sell it for his benefit. If such a case shall ever arise, the courts will find some way to dispose of it. So this plaintiff can not be compelled to accept the stock divided to him, and thus incur the possible liability which it may impose upon him as a stockholder. In case of his refusal the corporation will find some way to deal with the stock which the law will sanction, but which need not now be pointed out.

We have no occasion to scrutinize the motives of the defendants. The trial judge refused to find the alleged fraud and conspiracy, and his finding concludes us. In his opinion he said: "I have also found that the other allegations of fraud and conspiracy made in the complaint against the defendants and others were not proved on the trial. One of the very able counsel for the plaintiff, in his argument at the close of the trial in this case, said that he was not going to

lament the fact that he had failed to show such combination, that he had not been able to prove certain things by the defendants;" and the opinion of the court at the general term is to the same effect: "The complaint, among other things, charges that the corporate action complained of was the result of a fraudulent conspiracy on the part of the individual defendants, but the allegations in that respect were not sustained by the proof at the trial, nor has there been an argument made in their support upon the present appeal."

We are, therefore, of opinion, upon the facts found at special term, that the stock dividend was authorized by law and, therefore, valid.

*Reversed.*

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**Sec. 545.** (d) What is a severance of the dividend fund from the other corporate funds.

HUNT v. O'SHEA.

1899. IN THE SUPREME COURT OF NEW HAMPSHIRE. 69 N. H. 600, 45 Atl. Rep. 480.

Appeal from probate court, Belknap county. Proceedings by N. P. Hunt, receiver, against Dennis O'Shea, assignee of the insolvent estate of the Laconia Car Company. The probate court allowed plaintiff's claim, but denied his motion to order it paid in full, and plaintiff appeals, and also brings assumpsit for the same cause of action. Appeal dismissed, and judgment for defendant in the action at law.

The plaintiff is the receiver of the People's Fire Insurance Company, and, as such, on July 1, 1894, was the holder of 150 shares of the capital stock of the Laconia Car Company as collateral for a note which has not been paid. The car company, before that time, had legally declared a dividend payable on that date, which, on this particular stock, has not been paid. January 25, 1897, proceedings were instituted upon which the car company were decreed insolvent debtors, and the defendant was appointed as their assignee. The plaintiff's claim for this dividend was allowed in the probate court, but that court denied his motion to order it paid in full.

YOUNG, J. This court has no original jurisdiction of claims against the estate of an insolvent debtor (Pub. St., ch. 201, § 1), so the action of assumpsit must be dismissed, for the defendant has no money in his hands which equitably belongs to the plaintiff. Simply declaring a dividend does not create a trust fund. *Lowne v. Insurance Co.*, 6 Paige 482. To create such a fund, some specific sum of money must be set apart for the purpose of paying the dividend. Until this is done, the relation of the corporation to its stockholders in respect to dividends is that of debtor and creditor. *King v. Railroad Co.*, 29 N. J. Law 82; 1 Mor. Priv. Corp., section 445. No sum of money

having been set apart to pay this dividend, and the claim not being one of those named in section 32, ch. 201, Pub. St., the appeal should be dismissed, and judgment entered for the defendant in the action at law. All concurred.

*Note.* See, 1860, *King v. Paterson & H. R.*, 29 N. J. L. 82; 1893, *Ford v. Easthampton R. T. Co.*, 158 Mass. 84, 35 Am. St. Rep. 462 (vote declaring a dividend may be rescinded before it is made public); 1896, *Dennis v. Joslin Mfg. Co.*, 19 R. I. 666, 61 Am. St. Rep. 805 (parol evidence is not admissible to show that a corporation voted a dividend as an offset to moneys withdrawn by shareholders); 1900, *Price v. Morning Star Mining Co.*, 83 Mo. App. 470 (until the dividend is set apart it remains corporate property and the right thereto passes with the stock).

## Sec. 546. Same.

### LE ROY v. THE GLOBE INSURANCE COMPANY ET AL.<sup>1</sup>

1836. IN THE VICE CHANCELLOR'S COURT, NEW YORK. 2 Edw. Ch. (N. Y.) \*657-674.

[Bill in equity by plaintiff upon behalf of himself and other shareholders similarly situated.]

The directors of the Globe Insurance Company passed a resolution on the tenth of November, 1836, declaratory of a dividend; and on the thirtieth day of the same month such dividend was carried, on the books of the company, to profit and loss, leaving the capital entire, and a further surplus to the credit of the company for profits then earned and not divided. Public notice was given (in the newspapers of the eleventh of November) that this dividend would be paid on and after the first of December. Checks on one of the banks were prepared and filled up with each party's dividend. These checks were all dated the first of December, signed by the president and made payable to the order of the secretary of the company, and were placed in the hands of the latter to be indorsed by him and delivered over to the stockholders as they should call. About four-fifths of these checks had been called for. The great fire rendered the insurance company insolvent, and its affairs fell into the hands of receivers under the act. A stockholder, who was entitled to participate in this dividend, came, after the fire, for his check, and it was refused him. Question, whether the dividend for him had been so far set apart as to give him a right to it notwithstanding the insolvency of the company and the passing of their affairs into receiver's hands or whether it fell back into the general property of the company.

THE VICE-CHANCELLOR (McCOUN). This case does not necessarily call for a decision of the question whether, as between the stockholders of an insolvent insurance company and the creditors, the former are entitled to all the surplus which remained with the company undivided at the time of its disaster, over and above the entire capital.

<sup>1</sup> Statement as given in the syllabus; arguments and part of opinion upon another point omitted.



Although there is here such a surplus of upwards of forty-one thousand dollars, besides the dividend, amounting to thirty-five thousand dollars, which was declared on the tenth day of November and made payable on and after the first day of December, yet the complainants, in their bill, only claim to have their parts or portions of this dividend, which they have not received, now paid over to them out of the funds in the hands of the receivers, instead of leaving the money there to be applied as assets of the company in discharge of its debts.

The complainants assert their right to the money upon the ground of its having become theirs by an express appropriation, and setting apart so much out of the company's earnings for the stockholders, and thereby distinguished from the general mass of the company's funds; and I am convinced that enough has been done to produce this separation in the view of a court of equity, and to confer upon this amount the character of a trust fund which could not afterwards be diverted to other objects.

The investigation of the affairs of the company, and the ascertainment of a clear surplus to warrant a dividend; declaring that dividend by a resolution of the board of directors; fixing the period for its payment; giving publicity to it; carrying the amount on the books of the company to the debit of profit and loss; apportioning the same among the stockholders, by filling up and signing checks upon the bank where the funds were deposited for the purpose of being delivered to each stockholder when called for—these are all acts which the company, by its officers, might lawfully perform. These acts became binding upon the company in its corporate capacity and gave to the stockholders individually rights which the directors and officers of the company could not afterwards take from them. If, for instance, they had refused, after the first day of December, to deliver out the checks or make payment of the dividends, and no insolvency had intervened, it appears to me there would have been no difficulty in the remedy by mandamus in favor of all the stockholders, or by action at the suit of individuals from whom the payment was withheld.

Neither, I apprehend, could there be any valid objection to a bill in equity for the purpose of obtaining possession of the checks or the fund in the bank upon which they were drawn, upon the footing of its being a trust fund which the officers of the company were bound to distribute after the first day of December, and over which they had no other control. That the officers of the company considered the money which was deposited to its credit in the bank appropriated to meet the checks, is evidenced by the fact that they went on delivering out checks to such of the stockholders as called for them, until the seventeenth of December, when the disastrous fire had occurred; and they would have delivered checks to these complainants in like manner, if they had called to receive them. It makes no difference, in my judgment, that the money was not told out and specifically set apart in the bank to meet these checks, or that a separate fund was not created for the purpose, or that the money intended to meet them

still formed a part of the general mass standing to the credit of the company on the books of the bank; for this court can, nevertheless, lay hold of the mass, and separate so much as may be necessary to accomplish what was intended, and which accident alone prevented at the time. Up to the moment of the prostration of the company the intention remained, on the part of those who were charged with the management of its affairs, to continue the appropriation and consummate the payment of the dividends, which had been nearly completed. It was a matter no longer executory in the view of the parties; and so far as it remained unexecuted this court will now perform it. The intention must be fulfilled, and for this purpose a court of equity will consider, not merely the sums which were paid out in dividends, but the whole thirty-five thousand dollars, as actually appropriated and set apart for distribution among the stockholders from and after the first day of December, and regard it as a trust fund to which the stockholders had acquired vested rights—not in their corporate capacity, but as individuals to whom the money legally and equitably belonged, distinct from their other interests in the funds and effects of the company.

Having acquired this right, as between them and the corporation, the assignment or transfer to the receivers could not take it away. The receivers do not stand in the light of purchasers for valuable consideration without notice; and under such circumstances as exist here, are bound by the trust: *Adair v. Shaw*, 1 Sch. & Lef. (Irish Ch.) 243, on 262; *Wood v. Dummer*, 3 Mason's R. 308, 312.

The act of the eighteenth of January, one thousand eight hundred and thirty-six, under which the receivers were appointed, vests in them all the property and effects of the corporation; but, like any other assignment by operation of law, such as in bankruptcy, or under our insolvent acts, it does not pass trust property, but only such as the bankrupt or insolvent held or was possessed of or entitled to for his own benefit. \* \* \*

*Decree for plaintiff.*

See preceding case.

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**Sec. 547. (c) Who are entitled to dividends.**

**JERMAIN, RESPONDENT, v. THE LAKE SHORE AND MICHIGAN SOUTHERN RAILWAY COMPANY, APPELLANT.<sup>1</sup>**

1883. IN THE COURT OF APPEALS OF NEW YORK. 91 N. Y. Rep. 483-495.

[Action to compel defendant to declare and pay dividends of ten per cent. per annum from June, 1857, to February, 1863, upon shares owned by the plaintiff, the certificates for which read as follows:

<sup>1</sup> Statement abridged; arguments and part of opinion omitted.

"The Lake Shore and Michigan Southern Railway Company guaranteed ten per cent. stock. This is to certify that J. B. Jermain is entitled to forty shares of \$100 each, in the guaranteed capital stock of the late Michigan Southern and Northern Indiana Railroad Company, denominated construction stock. Said stock is entitled to dividends at the rate of ten per cent. per annum, payable semi-annually in New York on the first days of June and December in each year, out of the net earnings of the said company; and is also entitled to share *pro rata* with the other stock of the company in any excess of earnings over ten per cent. per annum, and the payment of dividends as aforesaid is hereby guaranteed. The said stock is transferable only on the books of the said company in their office in the city of New York, by the said stockholder in person or by his attorney, on the surrender of this certificate. In witness whereof the said company have caused this certificate to be signed by their president and treasurer, and countersigned by the registrar at New York this 12th day of December, 1870. H. F. CLARK, President.

"JAMES H. BANKER, Treasurer."

Plaintiff became owner of these shares December 12, 1870, but how, or from whom, did not appear, though his ownership was not disputed. No dividends on the preferred stock had been paid prior to July 1, 1863, but after that such dividends were regularly declared and paid by the company; afterward a large surplus of earnings was accumulated, and instead of paying arrears of dividends upon the preferred stock, dividends were declared and paid out of this surplus on the common stock. Plaintiff claims he is entitled to have these arrearages of dividends on preferred stock declared and paid.]

EARL, J. \* \* \* We are thus brought to the sole question of law involved upon this appeal, which is, whether treating the plaintiff as the assignee of forty shares of the guaranteed stock on the 12th day of December, 1870, he obtained the right to payment of the dividends which he seeks to enforce in this action.

A person who subscribed for and received the guaranteed stock in 1857 was not simply a stockholder in the company, neither was he simply a contractor with the company holding a contract which entitled him to payments of the guaranteed dividends, but he was both a stockholder and one holding such a guaranty, and the guaranty related to and was an incident of the stock and passed with it to any assignee of the stock. The certificate which evidenced his ownership of the stock also evidenced the guaranty of dividends, and the guaranty was to the person holding the stock.

The certificate issued to the plaintiff was not itself the stock, but only the evidence thereof. The stock had been in existence from the time it was issued in 1857, owned, if it had been from time to time transferred, by the successive transferees thereof. A share of stock represents the interest which the shareholder has in the capital and net earnings of the corporation. The interest is of an abstract nature, that is, the shareholder can not by any act of his, nor ordinarily by any act of the law, reduce it to possession. He can take, and is entitled

to take, the surplus profits when a dividend has been declared by the proper officers of the corporation, and upon dissolution of the corporation he can take his share of the assets thereof left for distribution, *pro rata*, among the shareholders. The corporation represents the whole body of the shareholders, and to it, before a dividend has been declared, belong, *in solido*, all the assets in which the shareholders, as such, are interested. When a dividend has once been declared out of net earnings, the amount of such dividend is no longer a part of the assets of the company, but is apportioned or set apart for the shareholders. They receive credit for the dividends and the corporation simply holds them as their trustee. Therefore, before a dividend has been declared, a share of stock represents the whole interest which the shareholder has in the corporation, and when he transfers his stock he transfers his entire interest, and dividends subsequently declared, without reference to the source from which or the time during which the funds divided were acquired by the corporation, necessarily belong to the holder of the stock at the time of the declaration. But when the dividend has once been declared and credited to the shareholder, the amount thereof has been separated from the assets of the corporation and been appropriated to his use. It is then no longer represented by his stock, and is no longer an incident thereof; and hence when he transfers his stock he does not transfer his dividend, which remains subject to his control.

But the claim on the part of the appellant is, that inasmuch as these guaranteed dividends were payable in 1864, long before the transfer of any stock to this plaintiff, they are to be treated as dividends then declared, and therefore payable to the person who then held the stock; that in 1864, by reason of the existence of net earnings sufficient to make the guaranteed dividends, the right to such dividends became vested in those then holding the guaranteed stock; that the net earnings then on hand representing the amount due for the guaranteed dividends were no longer a part of the capital or assets of the corporation, and that the right to them ceased to be an incident of the stock. This reasoning does not satisfy us. These net earnings were in no way set apart or appropriated for the benefit of the holders of the guaranteed stock. They were not even held by the company. The right of the guaranteed shareholders was repudiated and denied, and the net earnings were otherwise appropriated. They were no more legally appropriated to the payment of the guaranteed dividends than the property of a debtor is in law appropriated to the payment of debts which he refuses to recognize. The dividends, therefore, remained payable upon the stock to the holders of the stock. It matters not that payment could have been enforced by the holder of this stock; he did not then enforce it, and did not receive payment. He did not, so far as appears in the case, in any way separate his right to dividends from the stock as an incident thereto. It remained like interest payable upon any obligation which had not been paid, but which was due. An assignment of

the obligation in such a case carries with it the right to receive the over-due interest, the interest being an incident of the obligation.

Interest after it becomes due may be assigned to one person, and the principal obligation may be assigned to another, as the owner of this stock could have assigned these guaranteed dividends to one person and the stock to another; but until he did so, or did some act to separate the guaranteed dividends from the stock, a sale or assignment of the stock carried with it a right to the dividends, as an incident thereto. This conclusion is sustained by many analogies in the law, is believed to be in accordance with the common understanding and practice in such cases, and is, we think, quite fully sustained by the opinion in *Boardman v. The Lake Shore and Michigan Southern Railway Co.*<sup>1</sup> In that case the plaintiff did not become the owner of his stock until 1862, and yet he was held entitled to recover the guaranteed dividends from 1856 until 1863, without any other assignment to him except the assignment of the stock from the persons who held it from 1857 down to the date of the assignment to him. We do not think it is a material circumstance distinguishing that case from this, that there the plaintiff became the owner prior to 1864, whereas in this case the plaintiff became the owner after 1864. In each case the dividend was payable by virtue of the guaranty. It is true that in the prior case there was no dividend due or enforceable at the time the plaintiff took his stock, whereas there was a dividend due and enforceable at the time this plaintiff took his stock. But in both cases the dividend is due by virtue of the contract, a contract connected with, and parcel of, the contract which entitles the holder to his stock. In the *Boardman* case, Miller, J., said: "Conceding that the right of the plaintiffs depends upon a contract, that contract is connected with, relates to, and constitutes an integral part of, the plaintiffs' rights as a stockholder. It can not be separated from the rights accruing by virtue of the stock which the plaintiffs hold; and being thus a part and parcel of the same, it passes with the transfer as one of the incidents, and as composing an essential element thereof. A sale or assignment of the stock transferred, by operation of law, all benefits to be derived from the same and all profits, income or dividends or right to dividends by contract which formed a constituent, valuable and inseparable portion of the stock. When the contingency happened, specified in the contract, the right to dividends became fixed and existed independent of any act of the corporation or its officers. It became absolute and perfect in the stockholder, without a declaration to that effect, and passed as an incident of the stock upon the transfer."

Again, "we think it can not be maintained, upon any sound principle, that the contract for the payment of dividends continues to each stockholder only during the time he holds the stock and accrues only to his benefit during that period, and that a separate and distinct assignment of the dividends was essential in order to confer title upon the owner." The case of *Manning v. The Quicksilver Mining Co.* (24 Hun 360) is a case precisely in point. There the owner of certain

<sup>1</sup> 84 N. Y. 157.

preferred shares of stock in a mining company, after having sold the same and delivered the certificates thereof to one person, assigned to another all his right, title and interest in and to the interest due upon the assigned shares of stock which he had previously owned. By the terms of the certificates interest was guaranteed to be paid annually, but out of the net earnings of each year, providing so much in the year preceding had been earned. It did not appear that there had been any separation of this interest from the other assets of the company, or that any of the earnings of the company had been assigned to the payment of the interest, and it was held that the right to recover the interest was merely an incident to the shares themselves, and depended upon the title thereto, and that the assignee of the interest could not maintain an action to recover the interest or compel the company to account therefor.

We are, therefore, of the opinion that the decision of the general term is right, and should be affirmed, and judgment absolute ordered against the defendant with costs.

All concur, except Andrews and Rapallo, JJ., taking no part.

Order affirmed and judgment accordingly.

*Note.* See next case; 1901, *Clark v. Campbell*, 23 Utah 569, 90 Am. St. R. 716.

## Sec. 548. Same. Option contracts.

### BRIGHT v. LORD ET AL.

1875. IN THE SUPREME COURT OF INDIANA. 51 Ind. Rep. 272-277, 19 Am. Rep. 732.

BIDDLE, C. J. The facts averred in the appellant's complaint are as follows:

That on 1st day of April, 1873, the appellant entered into a provisional contract with John M. Lord, John Lord, and Charles M. Lord, by which they agreed to sell to the appellant five hundred and twenty shares of the capital stock of the Indianapolis Rolling Mill Company, of fifty dollars each, for the sum of thirteen thousand dollars, at the option of the appellant, to be by him taken at any time on or before the 18th day of June, 1873, to be paid for on delivery; that before the expiration of said option, on the 14th day of June, 1873, the said Lords, for the consideration of one hundred dollars, to them paid by appellant, extended the time of said provisional contract for thirty days, within which time the appellant paid the Lords thirteen thousand dollars, and received the stock, which, on the 16th day of July, 1873, was duly transferred to him on the books of the rolling mill company; that the appellant purchased the stock without the reservation of any dividends or earnings, and with all the benefits and interests that pertain to the same; that on the 3d of July, 1873, the board of directors of the rolling mill company declared a dividend on the capital stock of the company of five per cent., to be paid on the 1st day of August ensuing, amounting, on the stock, etc., purchased by the appellant, to



thirteen hundred dollars, which the appellant claims; that the company was about to pay the said thirteen hundred dollars to the Lords, who also claimed the amount. Prayer to restrain the company from paying the thirteen hundred dollars to the Lords, to decree the amount to the appellant, and for general relief.

The rolling mill company was served with process but made default.

Interlocutory proceedings were had after complaint and before answer, but as no question is raised upon them they are not stated.

The Lords answered by a general denial. The case was submitted to the court for trial, which resulted in a finding for the defendants. Motion for a new trial overruled. Exception. Appeal to the general term, where the judgment was affirmed, from which an appeal was taken to this court.

The only error assigned here is in affirming the judgment at the general term. The evidence is before us, and we think it fairly proves the allegations in the complaint.

Was the appellant entitled to the dividend declared while it was optional with him to purchase or refuse the stock, and before the purchase was completed? This is the sole question in the case.

Where a stockholder in a railroad assigned and transferred his stock after two years' interest had accrued, which, by a resolution of the company, was payable annually, and had been carried to the account of the stockholder, it was held that the interest did not pass by the assignment of the stock; the court stating the rule to be, that "the interest follows the principal, as an incident to it, so long as it remains an incident; but when it is separated and set apart from the principal by actual payment, or by being carried, when due, to the credit of the owner of the principal in his account with the debtor, and this in pursuance of a provision in the contract creating and defining the principal debt, it is so separated and disjoined from the principal as to cease to be an incident to, and does not follow it." *The City of Ohio v. The Cleveland, etc., R. Co.*, 6 Ohio St. 489. And in the case of *Jones v. The Terre Haute and Richmond R. Co.*, 29 Barb. 353, it was held, that "where, by a resolution of the board of directors, a dividend is made to the persons then holding stock, without any discrimination, out of the surplus earnings of the corporation for a given period, payable at a future day, all who are stockholders on the books of the company, at the time the dividend is declared, are entitled to share therein." This case seems to us as being remarkably similar to the one before us. It has also been held that the purchaser of a share of stock in a corporation has the right to receive all future dividends, from whatever source the profits may arise, provided he remain a member of the corporation until a dividend is made. *March v. The Eastern R. Co.*, 43 N. H. 515.

The same rule was recently held in England. The testatrix was owner of certain shares in the South Australian Banking Company. On the 7th day of June, 1865, dividends were declared by the com-

pany, payable on the 15th of July, 1865, and on the 15th of January, 1866. On the 31st of December [1865], the testatrix died, having made her will, devising the stock, in 1863.

The question arose as to whether the dividend due on the 15th of January, 1866, passed to the devisee, or belonged to her residuary estate.

Sir W. Page Wood, V. C., said: "As soon as the dividend was declared, although payment, for convenience of the company, was postponed until the following January, from that moment the testatrix became entitled to it, although she could not have then recovered it, and it would have passed to her legatee had she specifically bequeathed it." *De Gendre v. Kent*, 4 Equity Cases, 283.

In an American case, still later, it was held that a dividend belongs to the owner of the stock, at the time the dividend is actually declared, and that dividends made to the stockholders after the death of a testator belong to the widow who owns the stock, but if made before, although payable afterwards, they will pass by the devise. *Brundage v. Brundage*, 65 Barb. 397.

In support of this general principle, see, also, *In re Foote*, 22 Pick. 299; *Clapp v. Astor*, 2 Edwards Ch. 379; *Phelps v. Farmers' and Mechanics' Bank*, 26 Conn. 269; *Hyatt v. Allen*, 56 N. Y. 553.

From the authorities and upon principle, we think, the rule may be deduced, that whoever owns the stock in a corporation at the time a dividend is declared owns the dividend also; and a sale of the stock afterwards will not carry the dividend with it, though it may not be paid, or payable, until after the sale. The same rule governs in the sale of bonds or other securities, where the interest is payable at stated periods, as upon coupon bonds; but when the interest is accruing from day to day, whatever is due on the bond or other security at the time it is sold, will pass with it. The reason of the distinction is, that when the interest accrues from day to day, it is divisible and payable at any time; but when the interest is payable at stated periods, no part of it is due until the period arrives; and in the earnings or profits of stocks, it is impossible to know what amount is due until the dividend is declared.

In the case before us, Bright did not become the owner of the stock until the 16th day of July, 1873. Up to that time it was optional with him to purchase it or refuse it. The Lords would have had no remedy if Bright had refused the stock, and Bright would have suffered no loss, except the consideration he had paid for the option, and incurred no liability whatever. The dividend had been declared on the 3d day of July, 1873, and the amount fixed by which it became the property of the Lords at that time, although not payable until the 1st day of August ensuing; and there is nothing in the complaint to inform us but what Bright knew all these facts at the time he completed the purchase of the stock. At least, ordinary business diligence would have informed him of the facts, if he did not actually know them, and then he could have purchased the stock, as it then stood, or not, at his option. As he has not averred in his

complaint that he did not know these facts, and could not have ascertained them by ordinary business diligence, he must be held to have known them, and to have made his purchase accordingly.

The judgment is affirmed.

*Note.* Compare, 1835, *Harris v. Stevens*, 7 N. H. 454; 1871, *Currie v. White*, 45 N. Y. 822; 1878, *Black v. Hornersham*, L. R. 4 Exch. Div. 24. See, also, 1901, *Clark v. Campbell*, 23 Utah 569, 90 Am. St. R. 716.

**Sec. 549. (f) Rights of life tenant and remainder-man to dividends.**

McLOUTH v. HUNT.<sup>1</sup>

1897. IN THE COURT OF APPEALS OF NEW YORK. 154 N. Y. Rep. 179-198, 39 L. R. A. 230.

[Amicable suit to obtain a construction of the will of Caroline Cuyler, and a direction of the trustees with respect to their duties thereunder. Mrs. Cuyler died in 1888, and her will, duly probated, after various specific devises, left the rest of her property, to be divided into three parts, to her executors in trust for each of her three grandsons, such part of the income thereof as the trustees should deem proper for their support to be paid till they came of age; after that the whole income of each part to be paid to each till he arrived at the age of thirty-five years, when the whole of each part was to be paid to each respectively; but if either one died before he was thirty-five years old, his share should be paid to his descendants, if any, and if not, then to remain in trust for the surviving brothers. Among the property constituting the trust were 254 shares of stock in the Western Union Telegraph Company, upon which, in 1892, a ten per cent. stock dividend was declared from the surplus earnings of the company. One of the trustees claimed this dividend should be treated as income and be paid to the grandsons as such; the other, that it was capital, and should be held to be part of the estate, to be held in trust for the descendants or survivors of the brothers, the *cestuis que trust*, in case one should die before reaching the age of thirty-five years. The court below held the stock dividend to be income, instead of a part of the fund to be held in trust.]

O'BRIEN, J.. \* \* \* In discussing these questions it will be more convenient to consider the grandchildren, before reaching the age of thirty-five, as life tenants, and after arriving at that age as remainder-men, although such a classification may not be strictly accurate. The case is obviously governed by the same rules and principles that prevail in the determination of legal questions between the owner of an estate for life and the owner of an estate in the same property in remainder, and the analogy is so perfect that we may adopt it in order to avoid confusion of terms and to bring the discussion within the language of the authorities cited, and which are conceded to have more or less application to the case. \* \* \*

<sup>1</sup> Statement abridged. Part of opinion relating to proper method of applying income and premiums upon United States bonds, and arguments, omitted.

With respect to the stock dividends upon the stock of the Western Union Telegraph Company, embraced in the trust, it is important to notice the finding of the referee. For the purposes of the case the parties stipulated, and the referee found, that in the fall of 1892 the Western Union Telegraph Company, by a capitalization of accumulated earnings made and retained in its hands, from time to time, increased its capital stock from \$86,200,000 to \$100,000,000, and predicated thereon made a stock dividend of ten per cent. to its stockholders, under which the plaintiffs received in December of that year from the corporation a certificate for twenty-five and four-tenths additional shares of stock, making, with the 254 shares previously held by them, 279 4-10 shares.

There is doubtless much stronger and more weighty authority to support the contention of the appellant with respect to this question than the one just considered. We shall not attempt any extended or critical analysis of the numerous cases in which the question whether such a dividend is to be treated as capital or income has been discussed and decided. It would enlarge the scope of the discussion beyond all reasonable limits, and in the end answer no useful purpose. It is quite sufficient to say that they are in hopeless conflict, though, as it seems to us, the general trend of the more recent ones, as well as the weight of argument and reason, sustain the decision in this case. With respect to this question the appeal is sought to be sustained, first, by a class of cases in England founded upon *Brander v. Brander* (4 Vesey 800), and followed by *Irving v. Houstoun* (4 Paton Sch. Ap. (Cr. S. & P.) 521); *Paris v. Paris* (10 Vesey 185), and *In re Barton* (L. R., 5 Equity Cases 238).

Apart from the evident inclination of the judicial mind at that day in that country to favor entails, perpetuities and accumulations of property, it can hardly be said that these cases were well considered. Lord Chancellor Eldon admitted this in *Paris v. Paris* (*supra*), where he said: "I confess I do not think I can safely rest upon any distinction between this case and those that have been determined. I have had great difficulty in stating the principle that led to them. But in the case from Scotland great inquiry was made as to the length to which practice had carried the decisions here and at the rolls; and, as it appeared that it had gone to great length, the house of lords did not think it proper to disturb them." Then proceeding to notice the argument now made in this case, that there is a distinction between stock and cash dividends, he disposed of that contention with a homely but expressive remark. He said: "As to the distinction between stock and money, that is too thin; and if the law is, that this extraordinary profit, if given in the shape of stock, shall be considered capital, it must be capital if given as money."

The rule as thus established in England was followed in Massachusetts, more as one of convenience than of justice, in a line of cases that are not quite consistent with each other. (*Minot v. Paine*, 99 Mass. 101; *Daland v. Williams*, 101 Mass. 571; *Leland v. Hayden*, 102 Mass. 542; *Heard v. Eldredge*, 109 Mass. 258; *Rand v. Hubbell*,

115 Mass. 461; Davis v. Jackson, 152 Mass. 58.) The rule was adopted there mainly upon the authority of the early English cases to which reference has been made.

The supreme court of the United States laid down the same rule in *Gibbons v. Mahon* (136 U. S. 549), evidently following the doctrine of the English and Massachusetts cases. Mr. Justice Gray, who delivered the opinion, was a member of the supreme court of Massachusetts when the rule was established in that state. It can not be doubted that these cases are authority in support of the appellant's contention, and yet, notwithstanding the exalted character of the courts from which they proceed, they are not binding upon us, except in so far as they appear to be founded upon reason and justice. We have recently had occasion to declare the extent to which we are bound by the decisions of even such a great tribunal as the supreme court of the United States, and the weight to be given to its judgments upon such questions of general law as we are now considering. (*Bath Gas Light Co. v. Claffy*, 151 N. Y. 24.) Moreover, it is by no means clear that the decision in this case is in conflict with the case of *Gibbons v. Mahon* (*supra*). The rule for the determination of the question whether stock dividends were to be treated as income or an apportionment of capital, was stated by the learned justice in the following language: "When a distribution of earnings is made by a corporation among its stockholders, the question whether such distribution is an apportionment of additional stock representing capital, or a division of profits and income, depends upon the substance and intent of the action of the corporation as manifested by its vote or resolution."

In this case the resolution recites that the earnings of the corporation had been withheld from the shareholders for almost ten years; that they had accumulated, and that it was the intention of the directors in taking such action, and the shareholders in consenting to it, to distribute such accumulated earnings to the shareholders in the form of stock certificates instead of money. It was, therefore, the substance and intent of the corporate action to distribute earnings rather than apportion additional capital. There was, in fact, no additional capital added. The capital of a corporation is the money or property that it has after deducting its debts. The Western Union Telegraph Company had no more property after passing this resolution than it had before, and hence no more capital. When the resolution was carried out it had, indeed, more capital stock outstanding, as represented by certificates, but not a single dollar had been added to its capital. It had nothing after passing the resolution that it did not have before. So that, within the rule stated by the learned justice, what the shareholder got in this case represented income and was income. When the substance of the transaction is analyzed it will be seen that what the corporation really did was to issue to the shareholders its own obligations in the form of stock certificates against the accumulated earnings which it had on hand, and these certificates having a market value could readily be converted into money by the



shareholders. So that the transaction was, in substance, a distribution of profits.

In *Riggs v. Cragg* (89 N. Y. 479, 487) it was said by Chief Judge Andrews: "The right to stock dividends, as between tenant for life and remainder-man, has not been considered by the court of last resort in this state. The decisions upon the subject in other states and in England are conflicting, and it will be the duty of this court, when occasion arises, to seek to settle the question upon principle, and establish a practical rule for the guidance of trustees and others, which shall be just and equitable as between the beneficiaries of the two estates." This statement, with respect to the attitude of this court upon the question, was doubtless correct. But since this utterance was made, cases have been decided in this court which it will be found exceedingly difficult to reconcile with the doctrine of the early English cases and those of Massachusetts. (In *re Kernochan*, 104 N. Y. 618; In *re Gerry*, 103 N. Y. 445, 451; *Monson v. N. Y. Sec. and Tr. Co.*, 140 N. Y. 498; In *re Dewey*, 153 N. Y. 63.)

In so far as this court has touched the question at all since the decision in *Riggs v. Cragg*, nothing certainly can be found in the cases to sustain the contention of the appellant. The question had, however, been passed upon in the supreme court, upon full consideration, and the doctrine of the English cases and those of Massachusetts had been repudiated. (*Clarkson v. Clarkson*, 18 Barb. 646; *Riggs v. Cragg*, 26 Hun 90; *Simpson v. Moore*, 30 Barb. 637; *Goldsmith v. Swift*, 25 Hun 201.)

The same may be said with respect to the action of the supreme court of Pennsylvania, where it has been held that a stock dividend represented income, and belonged to the life tenant. (*Earp's Appeal*, 28 Pa. St. 368; *Moss' Appeal*, 83 Pa. St. 264.) In the latter case it was said: "Where a corporation having actually made profits, proceeds to distribute such profits amongst the stockholders, the tenant for life would be entitled to receive them, and this without regard to the form of the transaction. Equity, which disregards form and grasps the substance, would award the thing distributed, whether stocks or moneys, to whomsoever was entitled to the profits." The same rule was declared in New Jersey and New Hampshire. (*Van Doren v. Olden*, 19 N. J. Eq. 176; *Lord v. Brooks*, 52 N. H. 72.) There are other cases in these states to the same effect, but it is not necessary to refer to them. It is sufficient to say that in all of them the court refused to follow what is called the English and Massachusetts doctrine, for reasons that are stated at length, and which seem to be of great if not convincing force.

There are three very recent cases where the whole question has been carefully examined and the leading authorities critically reviewed by the highest courts in other states. These cases are *Hite v. Hite*, 93 Ky. 257 (1892); *Thomas v. Gregg*, 78 Md. 545 (1894); *Pritchett v. Nashville Trust Co.*, 96 Tenn. 472 (1896). In each of these cases the court was entirely unembarrassed by any previous impressions or decisions. The question was new, and from the conflict of authority in other



jurisdictions the courts, with admirable judgment and discrimination, proceeded to determine the question upon principle. It was held in each case that stock dividends, such as the one now under consideration, represented income, and in justice and equity properly belonged to the life tenant.

The reasoning of these cases seems to us far more cogent and persuasive than anything to be found in the cases which favor the contrary rule, that a stock dividend, such as was made to the trustees in this case, is an apportionment of capital and not income. It is impossible to read the English cases without being impressed with the statement of the judges, so often repeated, that they found great difficulty in formulating any principle upon which the decisions rested. An attempt to give a reason for the rule was made in one of the more recent cases, but without much success. (*Sproule v. Bouch*, L. R., 29 Ch. Div. 635, 638-653.) It was all summed up in the end by the court in a single sentence: "What the company says is income shall be income, and what it says is capital shall be capital." This is but another way of saying that whether accumulated earnings belong to the life tenant or the remainder-man depends upon the action of the corporation, and that the property rights of such parties under the will are governed by the mere form of capitalization; that the majority of a board of directors may give them to one or the other at their will. While such a rule might have the merit of simplicity and convenience, it ought not to determine the property rights of parties interested in the corporate property.

That a testamentary provision of this character, for the benefit of both the life tenant and the remainder-man, who are generally the nearest and dearest objects of the testator's bounty, can in this way be voted up or down, increased or diminished, as the corporation may elect, and that such action precludes the courts from looking into the real nature and substance of the transaction, and adjusting the rights of the parties according to justice and equity, is a proposition that can not be accepted. The mere adoption by the corporation of a resolution can not change accumulated earnings into capital, as between the life tenant and the remainder-man.

When questions arise under a will between parties standing in such relations to each other, with respect to the right to accumulated earnings upon capital stock, the courts must determine the questions for themselves, according to the nature and substance of the thing which the corporation has assumed to transfer from the one to the other, and they are not concluded by mere names or forms. For all corporate purposes the corporation may doubtless convert earnings into capital, when such power is conferred by its charter, but when a question arises between life tenants and remainder-men concerning the ownership of the earnings thus converted the action of the corporation will not conclude the courts.

The decision of the learned referee in awarding the stock dividend to the life tenants as earnings or income, and in refusing to charge them with the premium upon the bonds, or that part of it that has dis-

appeared by the lapse of time, is equitable and just, and, we think, is supported by reason and authority.

The judgment should, therefore, be affirmed, with costs to all parties payable out of the income of the fund.

All concur.

Judgment affirmed.

*Note.* The following cases are the principal ones upon the various views concerning the rights of the life tenant and remainder-man respectively: 1857, *Earp's Appeal*, 28 Pa. St. 368; 1868, *Minot v. Paine*, 99 Mass. 101; 1890, *Gibbons v. Mahon*, 136 U. S. 549; 1891, *Smith's Estate*, 140 Pa. St. 344; 1892, *Spooner v. Phillips*, 62 Conn. 62, 16 L. R. A. 461, note; 1892, *Hite's Devisees v. Hite's Executors*, 93 Ky. 257, 40 Am. St. Rep. 189, 19 L. R. A. 173; 1894, *Thomas et al. v. Gregg*, 78 Md. 545; 1896, *Pritchett v. Nashville Trust Co.*, 96 Tenn. 472, 33 L. R. A. 856; 1897, *Lysaght v. Lysaght*, 77 L. T. Rep. (N. S.) 637, 9 Am. & E. C. C. (N. S.) 697, note; 1901, *Quinn v. Safe Deposit Co.*, — Md. —, 53 L. R. A. 169; 1903, *De Koven v. Alsop*, 205 Ill. 309, 63 L. R. A. 587.

## Sec. 550. (g) Remedy of shareholders for withholding payment of dividends.

### JACKSON'S ADMINISTRATORS v. THE NEWARK PLANKROAD COMPANY.<sup>1</sup>

1865. IN THE SUPREME COURT OF NEW JERSEY. 31 N. J. Law  
277-281

THE CHIEF JUSTICE (BEASLEY). This is an action of *assumpsit*. The first two counts of the declaration are special, and, in substance, are identical; the gravamen of each consisting of the following circumstances, viz., that the plaintiff's intestate was the owner of certain shares of the capital stock of the defendants, for which he held certificates; that thereby he became a stockholder in said corporation, and entitled to all the rights of a shareholder and to a participation in the profits of said corporation, and to his share and full proportion of all profits made by said corporation, and of the dividends thereof declared or made among the shareholders; and that in consideration thereof the said corporation thereby promised said intestate that he should be entitled to all the rights of a shareholder therein, and that he should receive a share of the profits made by the said corporation, and of the dividends thereof declared among the shareholders, in proportion to the number of shares so held by him. The breach assigned is, that the defendants having made large profits, to wit, five per centum on each share of their capital stock, declared a dividend thereof to each of their shareholders, except to the plaintiff's intestate.

As the demurrer admits these facts it would seem to follow, as an inevitable conclusion, that the plaintiffs have a cause of action against the defendants, and that the only question to be considered is, whether

<sup>1</sup> Small part of opinion omitted.

it is enforcible in this present form of proceeding. The suit appears to be one of the first impression, but this circumstance is of no importance if it be founded in correct legal principles.

The theory upon which the plaintiff's case rests appears to be this: A person holding, as owner, the stock of a corporation, becomes thereby entitled to a proportionate share in the profits of the company; and that, consequently, a duty is imposed, by law, on the body corporate, to distribute all dividends which, from time to time, may be declared, ratably on all its capital stock; and from this duty, it is said, springs the implied promise stated in the declaration.

I am unable to perceive any flaw in this statement of principles, or in the deduction which is made from them. It is clearly, as a general thing, the duty of the corporation to give to each stockholder an equable share of such dividends as are declared, and it has been an established doctrine of the courts that most of the duties imposed upon corporations by law raise implied promises which will sustain, when broken, the action of *assumpsit*. A long line of well-considered decisions rest upon this foundation. It is not deemed necessary to refer to them in detail; a number of the most important will be found collected in Angell & Ames on Corporations, 384.

The class of adjudications which bears the closest analogy in principle to the case now considered, is that which relates to the remedy on the refusal of the corporation to transfer stock at the request of the owner. As long ago as the time of Lord Mansfield, it was decided that a special action of *assumpsit* was the remedy for such breach of duty. *Rex v. Bank of England*, Doug. R. 525, and the same rule has been repeatedly sanctioned and enforced by the courts of this country. *Shiple v. Mechanics' Bank*, 10 Johns. 484; Angell & Ames on Corp., chapter XVI. And upon like grounds in *Gray v. The Portland Bank*, 3 Mass. 364, it was held by the supreme court of Massachusetts, that a special action on the case would lie against an incorporated company for a refusal to permit one of its stockholders to subscribe for a fair proportion of certain new stock, which had been issued by the corporation, with a view to increase its capital.

It will be perceived that in each of these cases the promise sued on was implied from the legal duty due from the corporation to the stockholder, growing out of the mere relationship between them. It is one of the obligations of a corporation, inherent in its essential nature, to permit, at the request of the holder, a transfer of its stock; and as this is an obligation not due to the member at large, but exclusively owing to the individual stockholder, it was properly held that the law, upon its ordinary principles, implied an agreement on the part of the company to discharge such specific obligation. But the right to transfer stock is no more an incident to its ownership than is the right to dividends upon it; and the duty of the company, in making a distribution of profits, to appropriate a quota to each share of stock, is, in all respects, as definite and specific as is the duty to allow a transfer of stock on a sale. In neither case does the act to be done rest in the discretion of the company, and in both of them the duty is due.

not to the members in general, but to each separate stockholder. It is not perceived how these two classes of cases are to be discriminated. If a suable promise can be deduced from the absolute and specific duty to allow stock to be transferred, so must the same result follow from the absolute and specific duty to set off, when dividends are declared to each share of stock, its distributive allotment. It appears to me that the general rule, distinguishing between that class of duties which give rise to actionable promises by implication and those which do not, may be thus stated: that in all cases in which the duty is definite and due to the individual, such promise will be implied; but that, on the other hand, when such duties are indefinite or are due to the members in their collective capacity, no such promise can be inferred. Thus, as an illustration, the duty to declare a dividend, where profits are in hand, is one of the indefinite and general character alluded to, it is, to a certain extent, discretionary in its nature, and it is due, in no sense, to any particular member, but to the community of members, and hence there is no promise for its performance to be drawn in favor of the separate shareholder. But after a dividend is declared, the right to the profits becomes individualized, and the duty to distribute, in certain proportions, which, so far from being arbitrary, are mere matters of arithmetical calculation, becomes attached as a right to each member distributively; and from these incidents arises the promise by implication. \* \* \*

*Judgment for plaintiff.*

*Note.* See, 1819, *King v. Governor, etc., Co.*, 2 Barn. & A. 620; 1875, *Beers v. Bridgeport S. Co.*, 42 Conn. 17; 1891, *McNab v. McNab & H. Mfg. Co.*, 62 Hun 18; 1896, *Re Severn & W. & S. B. R. Co.*, 74 L. T. (N. S.) 219; 1897, *Winchester & L. T. Co. v. Wickliffe*, 100 Ky. 531, 66 Am. St. Rep. 356.

The power to declare dividends resides in the directors, and so long as they act in good faith in furthering the interests of the company the courts will not control their discretion by compelling them to declare dividends; but where their acts amount to a misapplication of funds, or they fraudulently withhold funds properly distributable as dividends, the courts will interfere upon an application by shareholders. 1866, *Pratt v. Pratt*, 33 Conn. 446; 1881, *Boardman v. R. Co.*, 84 N. Y. 157; 1886, *N. Y., L. E. & W. v. Nickals*, 119 U. S. 296; 1887, *Hazeltine v. R. Co.*, 79 Me. 411; 1890, *Hunter v. Roberts*, 83 Mich. 63; 1892, *Fougeray v. Cord*, 50 N. J. Eq. 185; 1893, *McLean v. Plate Glass Co.*, 159 Pa. St. 112; 1899, *Burden v. Burden*, 159 N. Y. 287; 1899, *Earle v. Burland*, 27 Ont. App. 540; 1901, *Morey v. Fish Bros. Wagon Co.*, 108 Wis. 520, 84 N. W. Rep. 862.

**Sec. 551. 4. Right to inspect books.**  
(a) In general.

**THE STATE OF WASHINGTON ON THE RELATION OF M. WEINBERG, RESPONDENT, v. PACIFIC BREWING AND MALTING COMPANY ET AL., APPELLANTS.<sup>1</sup>**

1899. IN THE SUPREME COURT OF WASHINGTON. 21 Wash. Rep. 451-465, 47 L. R. A. 208.

On August 10, 1898, the respondent applied to the court below for a writ of mandamus to compel the appellants to permit her to inspect

<sup>1</sup> Statement abridged, and part of opinion omitted.

the account books of the corporation. As a cause for the issuance of the writ, she alleged:

“That relator, as such stockholder, has for some time been desirous of learning the true condition of the affairs of said company, and of the management of its business, and of the value and nature of relator's interest and property therein as such stockholder, and of the manner and skill and fidelity with which relator's interests as stockholder, as aforesaid, are and have been attended to and protected, and to that end has sought to inspect and examine at proper and convenient times, and without interruption or embarrassment to said company, or to the management, or transaction of the business thereof, the books of account of said corporation, and has requested and demanded of said respondents permission, access and opportunity to so examine said books of account, but said respondents and each of them have always refused and still refuse relator such permission, access and opportunity.”

[An alternative writ was issued to allow the inspection or show cause why peremptory writ should not issue. Appellants moved to quash this on the ground that the prosecution should not be in the name of the state, as it had no interest in the matter; this was overruled. A demurrer was then interposed on the ground that the facts were insufficient to give a cause of action; this was overruled, and upon trial judgment and order for peremptory writ was given to the respondent. Appeal from the judgment and orders was taken.]

FULLERTON, J. (after holding that mandamus in the name of the state was a proper form of proceeding). \* \* \* Another question is, has the respondent shown facts sufficient to authorize the court to direct that a writ of mandamus issue? The stockholders of a corporation have, at common law, for a proper purpose, and at seasonable times, a right to inspect any or all books and records of the corporation. While this right is universally recognized, the courts disagree as to what is a proper purpose, or, rather, as to what facts are sufficient to warrant the court in directing by mandamus permission to inspect, where the stockholder has been refused such by the officers of the corporation. In the early case of *Rex v. Master and Wardens of the Merchant Tailors' Company*, 2 Barn. & Adol. 115, this question received consideration by the court of King's Bench in England, on which the several judges expressed opinions. The rule to show cause why a writ of mandamus should not issue was obtained upon the affidavits of certain liverymen and freemen of the company, who alleged, among other things, that the attention of the deponents had for a considerable time been called to the affairs of the company by reports, which they believed to be well founded, that the revenues of the company were misemployed through malpractices on the part of those members who had the management of the company's affairs; that the fine for admitting freemen to the livery had been recently twice raised, without any corresponding increase, as deponents were informed and believed, in the pensions and charitable disbursements of the company; that a lavish expense had taken place, unsanctioned by the ma-



majority of the members of the company; that a clerk of the company had, as deponents had heard and believed, misappropriated funds of the company to a large amount, but that no accounts or information had been laid before the freemen by which they could learn the amount of such defalcation, nor could they ascertain, unless allowed to look at their charters, by-laws, books, muniments, and documents, whether such their common funds were properly applied and accounted for or not; that they had no other wish in desiring the inspection of the books than to see, on behalf of a body of the members, by whom they were authorized, how their joint funds were disbursed, and that the legal rights and privileges of the members were enjoyed agreeably to their charters. On motion to discharge the rule, the judges were unanimous in the opinion that no sufficient cause was shown to warrant the court in issuing the writ. It was held that before the writ could issue some distinct cause or purpose affecting the applicant personally must be shown, and that a desire to examine the books for the purpose of ascertaining whether the company's affairs were being properly managed was not sufficient cause. Passing upon the motion, Littledale, J., said:

"The master and wardens, who have the care of the documents in question, are bound to produce them if a proper occasion is made out, in a matter affecting the members of the corporation. But I think the members have no right on speculative grounds to call for an examination of the books and muniments, in order to see if by possibility the company's affairs may be better administered than they think they are at present. If they have any complaint to make, some suit should be instituted, some definite matter charged; and then the question will arise whether or not the court will grant a mandamus."

Taunton, J., said: "There is no express rule that to warrant an application to inspect corporation documents there must actually have been a suit instituted; but it is necessary that there should be some particular matter in dispute, between members, or between the corporation and individuals in it; there must be some controversy, some specific purpose in respect to which the examination becomes necessary."

Patteson, J., said: "I am far from saying that there may not be particular instances in which a corporator may apply for a mandamus to inspect documents, or some of them, of the kind here mentioned, if he can show a specific ground of application, and that the granting of it is necessary to prevent his suffering injury, or to enable him to perform his duties. But he must state a definite object; and here that is not done."

The principle announced in this case has been followed by some of the courts of this country, in so far, at least, as to hold that the mere benefit of knowledge to be derived from the books as to the proper conduct of the business is not a sufficient cause for the issuance of the writ to compel the corporate officers to grant an inspection, but that something more must be shown; as that a controversy is depending, or that some question or interest is involved with reference to which



the contents of the books may be applicable. Of this class of cases, the following are illustrative: *People, ex rel. Hatch, v. Lake Shore & M. S. R. Co.*, 11 Hun 1; *People v. Walker*, 9 Mich. 328; *Commonwealth v. Phoenix Iron Co.*, 105 Pa. St., 111, 51 Am. Rep. 184; *Lyon v. American Screw Co.*, 16 R. I. 472, 17 Atl. Rep. 61.

The injustice of the rule, when applied in all its strictness, has been so keenly felt that in England, and in many of the United States, the right of inspection of corporate books is now guaranteed to the stockholders by statute, and such statutes seem to be generally held not to be innovations in, but declaratory of, the common law. The tendency of the modern decisions, also, is towards holding that a stockholder, as such, has a right to inspect the books and other documents of the corporation, where his sole object is to inform himself as to the manner in which the business of the corporation is being conducted. In *State, ex rel. Doyle, v. Laughlin*, 53 Mo. App. 542, the facts were that the relator was a stockholder in a banking corporation, and as such stockholder requested of the directors and officers of the bank the privilege of examining the books of the bank for the sole purpose of acquainting himself with the condition of its affairs, and how the bank was being managed. On the request being refused, he brought mandamus to compel the officers to allow such inspection. The court said:

"The right of a stockholder to examine and inspect all the books and records of a corporation at all seasonable times and to be thereby informed of the condition of the corporation and its property is a common-law right. \* \* \* It is quite obvious, therefore, that the relator has a clear right to examine the books of the bank in question. And though the relator in his application for the alternative writ took the precaution to state the purposes for which he sought to exercise the right of inspection, this, upon principle, we think, was unnecessary. If the right of inspection of corporate books exists, whether under the statute or at common law, the purpose of the exercise of the right is immaterial. *State ex rel. v. Sportsman's Park*, 29 Mo. App. 326. Because the right may be made the subject of abuse does not prove that it does not exist. The manner in which it may be exercised might well be regulated by the by-laws of the corporation. Such regulations would, of course, have to be reasonable. The right could not be regulated out of existence."

In *State, ex rel. Bourdette, v. New Orleans Gaslight Co.*, 49 La. Ann. 1556, 22 So. Rep. 815, the court said:

"No better way of safeguarding the interests of the public can, perhaps, be devised, or one that may be so easily and readily applied, as the right to the frequent, sudden and speedy examination of the books of corporations in the stock or shares of which investors and speculators are invited to trade. The recognition of this fact attests alike the wisdom and purpose of the framers of the constitution. The question here presented was virtually passed upon in *Legendre v. Brewing Association*, 45 La. Ann. 669, 12 So. Rep. 837, and adversely to the pretensions of defendant corporation herein. See, also,

State, *ex rel. Martin, v. Bienville Oil Works Co.*, 28 La. Ann. 204; *Cockburn v. Union Bank*, 13 La. Ann. 289. In the United States the prevailing doctrine appears to be that the individual shareholders in a corporation have the same right as the members of an ordinary partnership to examine their company's books, although they have no power to interfere with the management. (*Morawetz Priv. Corp.*, section 473.) This doctrine obtains with all the more force in this state by reason of its recognition in the constitution itself.

In *Lewis v. Brainerd*, 53 Vt. 519, an action brought under a statute to recover a penalty fixed by the statute for refusing to permit a stockholder to examine the books, the court, on affirming a judgment recovered for such refusal, said:

"The shareholders in a corporation hold the franchise, and are the owners of the corporate property; and as such owners they have the right, at common law, to examine and inspect all the books and records of the corporation, at all seasonable times; and to be, thereby, informed of the condition of the corporation and its property. Our statute provides the method of securing and enforcing such rights. The statute is remedial; it was enacted to secure rights and suppress fraud and wrong; and should be so construed and enforced as effectually to carry out the purpose of the legislature, and remedy the evil sought to be prevented."

In *Huyler v. Cragin Cattle Co.*, 40 N. J. Eq. 392, 2 Atl. Rep. 274, it is said:

"Stockholders are entitled to inspect the books of the company for proper purposes at proper times. \* \* \* And they are entitled to such inspection, though their only object is to ascertain whether their affairs have been properly conducted by the directors or managers. Such a right is necessary to their protection. To say that they have the right, but that it can be enforced only when they have ascertained, in some way without the books, that their affairs have been mismanaged, or that their interests are in danger, is practically to deny the right in the majority of cases. Oftentimes frauds are discoverable only by examination of the books by an expert accountant. The books are not the private property of the directors or managers, but are the records of their transactions as trustees for the stockholders."

See, further, *Cockburn v. Union Bank*, 13 La. Ann. 289; *State, ex rel. Martin, v. Bienville Oil Works Co.*, 28 La. Ann. 204; *Ranger v. Champion Cotton-Press Co.*, 51 Fed. Rep. 61, 62; *Deaderick v. Wilson*, 8 Baxt. 108; *Boone, Banking*, section 235; *Cook, Stock & Stockholders* (3d. ed.), section 511; *Thompson, Corporations*, section 4406 *et seq.*

In section 4418, the author in the last work cited quotes from the English cases announcing the rule that the right to inspect the books of a corporation will not be enforced unless there is a defined, distinct dispute, and adds:

"It should be carefully added, however, that this theory has gained no considerable footing in America, nor is it based upon any foundation of sense. Subject to the convenience of the others, or of the

common agency which acts for all, it is the right of every proprietor to know how the business in which he has embarked his money is being carried on, whether there is any dispute about it or not. Nor can this principle have any application where the right is given by statute."

In section 4407 the same author says: "In corporate management or mismanagement, no more frequent or more aggravated species of outrage exists than the refusal of those in possession of the corporate books to disclose to the stockholders the written evidences of their stewardship; and in many cases nothing short of severe pecuniary forfeitures, followed by imprisonment as for crime, will afford an adequate protection to minority stockholders."

Corporations, owing to the ease with which they can be formed under the liberal provisions of the statute, and affording, as they do, a limited liability for investors, have become a favorite means for the combination of capital, and are now engaged in almost every variety and character of business. In fact, they have largely superseded partnerships. Not having behind them the personal responsibility and fortunes of the promoters, or that of those who may have invested in their capital stock, the interests of the public at large require, and especially that part of the public dealing with them, that the courts adopt the rule which will most largely conduce to honesty in their management. We believe that these interests will be better protected by holding that a stockholder of a corporation has the right, at reasonable times, to inspect and examine the books and records of such corporation, so long as his purpose is to inform himself as to the manner and fidelity with which the corporate affairs are being conducted and his examination is made in the interests of the corporation. Nor will it be presumed, when such request is made, that the purpose of the inspection is other than in the interest of the corporation; and, when it is charged to be otherwise, the burden should be on the officers refusing such request, or the corporation, to establish it. The argument that, under this rule, the managers of a rival concern may acquire stock in the corporation and use the privilege for the purpose of benefiting the rival concern, to the detriment of the corporation, is not more forceful than the other that, under the restricted rule, a combination can be made by persons holding the majority of the stock, by which the corporation is managed for their own interests, to the exclusion and detriment of the minority holders and injury to the public dealing with it.

It is contended that the writ should have been refused because it is not shown that the demand for an inspection was made during business hours, or at the place of business of the corporation, or that the person making the demand was the agent of the respondent, or had any lawful right to represent her in the transaction. These objections would come with more force had the refusal to permit an inspection on the part of the officer in charge of the books been based upon some one or all of these grounds. But the refusal was made upon the broad ground that the respondent, as such shareholder, had no right to inspect the books of the company at any time or for any

purpose, and the main dispute in the court below seems to have been as to the existence of this right. The evidence, also, upon these points is contradictory, and, as the court found the facts in favor of the respondent, we do not feel disposed to disturb its findings.

The judgment is affirmed.

Gordon, C. J., and Reavis and Dunbar, JJ., concur.

*Note.* See the following cases upon the subject of inspecting corporate books: 1893, *Legendre v. N. O. Brewing Co.*, 45 La. Ann. 669, 40 Am. St. Rep. 243, note; 1895, *Ellsworth v. Dorwart*, 95 Iowa 108, 58 Am. St. Rep. 427, note; 1897, *Stone v. Kellogg*, 165 Ill. 192, 56 Am. St. Rep. 240; 1898, *Weihenmayer v. Bitner*, 88 Md. 325, 42 Atl. Rep. 245; 1898, *McElree v. Darlington*, 187 Pa. St. 593, 67 Am. St. Rep. 592; 1899, *State v. Citizens' Bank*, 51 La. Ann. 426, 25 So. Rep. 318; 1899, *In re Steinway*, 159 N. Y. 250, 45 L. R. A. 461; 1900, *Fuller v. Hollander*, 61 N. J. Eq. 648, 47 Atl. Rep. 646; 1900, *Cincinnati Volksblatt Co. v. Hoffmeister*, 62 Ohio St. 189, 56 N. E. Rep. 1033; 1902, *Johnson v. Langdon*, 135 Col. 624, 87 Am. St. R. 156 (improper purpose is no defense).

Although mandamus is the usual remedy (1899, *In re Steinway*, 159 N. Y. 250, 45 L. R. A. 461; 1900, *Fuller v. Hollander*, 61 N. J. Eq. 648, 47 Atl. Rep. 646), an action for damages will lie against the officers for refusal to permit examination (1893, *Legendre v. N. O. Brewing Co.*, 45 La. Ann. 669, 40 Am. St. Rep. 243, note; 1900, *Bourdette v. Seward*, 52 La. Ann. 1333, 27 So. Rep. 724).

## Sec. 552. Same. (b) In case of foreign corporations; general rule.

IN THE MATTER OF THE PETITION OF RAPPLEYE, APPELLANT, FOR AN INSPECTION OF THE BOOKS AND RECORDS OF THE FARMERS' FEED COMPANY, RESPONDENT.<sup>1</sup>

1899. IN THE APPELLATE DIVISION OF THE SUPREME COURT OF NEW YORK. 43 App. Div. Rep. (N. Y.) 84-87.

(Appeal from order of special term denying an application for mandamus to inspect books.)

BARRETT, J. \* \* \* The respondent is a foreign corporation, organized under the laws of New Jersey, and the appellant is one of its stockholders. It will be observed that the application for an inspection is not made in an action, either at law or in equity. It has, in fact, no relation to any cause of action which the appellant individually may have against the foreign corporation. The applicant simply asserts what he deems to be his right as a member of the corporation; and he seeks to enforce that right by a writ of mandamus. Jurisdiction has not been conferred upon the courts of this state to grant such a writ in enforcement of such a right. We undoubtedly have such jurisdiction, both at common law and by statute, in the case of a domestic corporation (*Matter of Steinway*, 159 N. Y. 250); but none as to foreign corporations. Our statute upon the subject relates exclusively to domestic corporations (*The Stock Corporation Law*, Laws of 1892, chapter 688, section 29), while our common-law jurisdiction is limited to that formerly possessed by the court of

<sup>1</sup> Part of opinion omitted.

king's bench in England. (Steinway Case, *supra*). That jurisdiction did not extend to foreign corporations. Mandamus was originally issued by the king to his subject ordering the performance of some specified act. Later, mandamus, though still a prerogative writ, was issued in the king's name from the court of king's bench and directed to persons and corporations within the king's dominions. In modern times the writ has been somewhat assimilated to ordinary remedies, but even as such it is still limited to the enforcement, as against persons or corporations within the king's dominions, of some duty prescribed by the law of the realm. The common-law jurisdiction here is limited in like manner. The member's right to inspect the books of a foreign corporation depends upon the law of that corporation's being, and can only be enforced by the courts of its legal existence. The foreign corporation as a legal entity is not here, although its officers, property and books may be found here; and its duty in the premises is not prescribed by the law of this state.

Our special jurisdiction over foreign corporations is conferred and regulated by statute. In an action against a foreign corporation properly instituted under our law, the ordinary remedies of discovery and inspection of books and papers are doubtless applicable. In such an action, too, production of the books within our jurisdiction can be compelled by subpoena *duces tecum* or authorized judicial order. But that is an entirely different affair from a proceeding by mandamus which has no other purpose, and looks to no other relief, save that of granting to the stockholder his membership right of inspection. In such an independent proceeding he substantially asks our courts to interfere in the internal management of the affairs of the foreign corporation—a request which has been refused in all the cases to which our attention has been called. \* \* \*

(Citing and commenting on *Howell v. Chicago & N. W. R. Co.*, 51 Barb. 378; *North State Copper & G. M. Co. v. Field*, 64 Md. 151, *supra*, p. —; *Madden v. Electric L. Co.*, 181 Pa. St. 617; *Republican M. S. M. v. Brown*, 58 Fed. Rep. 644; *Wilkins v. Thorne*, 60 Md. 253.)

The applicant here is not without redress. He may apply to the courts of New Jersey. It has been there held that where a corporation of that state does business and keeps its books outside of the state, it will be compelled to bring the books in for inspection of members. (*Huyler v. Cragin Cattle Co.*, 40 N. J. Eq. 392.) It can not, therefore, be said that our want of jurisdiction here leads to entire failure of justice. But, whatever inconvenience may result from our inability to grant a mandamus in such cases as this, we think it quite clear, both upon principle and authority, that the inability exists, and consequently the order appealed from was right and should be affirmed, with costs.

Van Brunt, P. J., Rumsey, Ingraham and McLaughlin, JJ., concurred.

Order affirmed, with costs.

*Note.* See, 1900, *Fuller v. Hollander & Co.*, — N. J. —, 47 Atl. Rep. 646.



**Sec. 553. Same. Exception.**

HOUSTON, J., IN *RICHARDSON v. SWIFT*.<sup>1</sup>

1885. IN THE SUPERIOR COURT OF DELAWARE. 7 *Houst. (Del.)*  
Rep. 137-176, on 152-3.

[Application for mandamus against the custodian of the books in Delaware, to compel the inspection of the books there of a foreign corporation doing business in the state. It was strenuously contended that such a writ for such a purpose could be allowed only by the state creating the corporation.]

If that be so, then it is manifest, whatever may be the legal right of the relator to the inspection and copies of the books and papers in question, that he is wholly without any specific remedy in law to enforce it here or elsewhere; because it is equally certain, whether we consider it a proceeding *in rem* or *in personam*, or as partaking of the nature of both, as the writ is to be specifically executed when issued, and both the *custos* and the books and papers are in this state, that they could not be reached by such a writ from any court in the state of Connecticut. And although that state may have the power, which this has not, to forfeit or revoke the charter of the corporation, and that should be done by it, the relator would still be left without his specific remedy in the case, either there or here.

Although our constitution declares that "the style in all process and public acts shall be the state of Delaware," and the writ is issued and prosecuted in the name of it on the complaint of the relator, the jurisdiction and authority of this court to issue it in such a case, even if this company were a domestic, instead of a foreign, corporation, would not emanate or result from the act of incorporation or the by-laws of the company, but from that higher jurisdiction and authority which, as I have before said, the constitution and the laws of the state have conferred upon the court in such a case and over the writ of mandamus and all other well-known writs at common law within the limits of the state. And we may therefore admit the correctness of the definition of the writ cited by the counsel for the defendant from Mr. Potter's work on corporations, volume 2, section 634: "That the writ issues by command of the sovereign power, and in the name of the state, and is directed to some subordinate court, judicature or body within the jurisdiction of the court from which it issues, and it requires the performance by the body to whom it is directed of a specific act, as being the legal duty of the office, character or situation," without impairing in any degree whatever the truth and soundness of this proposition.

<sup>1</sup>This case in the superior court, with the elaborate opinions of Houston, J., and Comegys, C. J., and Wooten, J., dissenting, and the opinions in the court of error and appeals (*Swift v. Richardson*, 7 *Houst. (Del.)* pp. 338-370, 40 *Am. St. Rep.* 127, note), Saulsbury, chancellor, affirming (Grubb, J., dissenting), the decision of the superior court, gives very fully the history of mandamus and the state's power of control over foreign corporations.



Well, now, if such be the general and fundamental principles of the law applicable to such a case, and the president of this corporation is residing in this state and city, and where it is now carrying on to some extent its corporate business, and has the books and papers of it in question in its possession and custody now in this state and within the jurisdiction of this court, and refuses to allow the relator to inspect and take copies of them for the purpose demanded of him, I am not able to perceive, after all the consideration which I have been able to give to the case, any good and valid reason for holding that the case is not within the jurisdiction of the court, or that it ought not, under all the facts and circumstances alleged and not disputed in it, to award the writ, as prayed in the petition of the relator. The right of the relator to the inspection and copies which he demands being a right founded on the common law of the state by virtue of his being a stockholder in this corporation, and the *res*, or books and papers, as well as the corporate *custos* of them, being within the jurisdiction of this court, and the same principle of the common law which confers that upon the former, imposes the duty on the latter to grant it, on what principle of law or reason can it be said that the case is nevertheless not within the jurisdiction of the court, because the company was not incorporated under a law of this state, but under a law of the state of Connecticut, although that right and that duty exists in both states by a law broader and more general than the act under which it was incorporated? \* \* \*

*Mandamus to issue.*

*Note.* See same case, 1886, *Swift v. Richardson*, 7 Houst. (Del.) 338, 40 Am. St. Rep. 127, note, and the case immediately preceding; 1900, *Fuller v. Hollander*, 61 N. J. Eq. 648, 88 Am. St. R. 456, 47 Atl. 646. Also, 1902, *State v. North Am. Land & T. Co.*, 106 La. 621, 31 So. 172, 87 Am. St. R. 309.

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**Sec. 554. 5. The right to transfer shares of stock.**  
 (a) Basis of the right.

See *Bloede Co. v. Bloede*, 84 Md. 129, *supra*, p. 1159.

*Note.* See, 1895, *Ireland v. Globe Milling Co.*, 19 R. I. 180, 61 Am. St. Rep. 756; 1897, *McNulta v. Com. Belt. Bk.*, 164 Ill. 427, 56 Am. St. Rep. 203; 1898, *Ireland v. Globe Milling Co.*, 21 R. I. 9, 79 Am. St. Rep. 769, 41 Atl. Rep. 258; 1899, *Herring v. Ruskin Co-op. Assn.*, — Tenn. Ch. Ap. —, 52 S. W. Rep. 327. See, also, monographic note upon restriction of the right to transfer shares, 57 Am. St. Rep. 379-396; also, 1902, *Barrett v. King*, — Mass. —, 63 N. E. 934.

As to the implied warranties arising from the sale of stock, see, 1900, *McClure v. Central Trust Co.*, 165 N. Y. 108, 53 L. R. A. 153, note.

Sales on margin may be forbidden, 1900, *Parker v. Otis*, 130 Cal. 322, 92 Am. St. R. 56, 62 Pac. 571, 927, 187 U. S. 606, 23 Sup. Ct. 169.

**Sec. 555.** (b) General doctrine as to transfer; nature of certificate and how transferred; refusal of corporation to transfer; remedy of holder at law and in equity; liability of corporation on old and new certificates; who is owner; *bona fide* transferee; theft, fraud, etc.

**KELLER, RESPONDENT, v. THE EUREKA BRICK MACHINE MANUFACTURING COMPANY, APPELLANT.**<sup>1</sup>

1890. IN THE ST. LOUIS COURT OF APPEALS. 43 Mo. App. Rep. 84-110.

[Action by Keller to compel the company to issue to him a new certificate of stock for 100 shares of \$100 each, in place of the original certificate, alleged to have been lost, and without the word "duplicate," or other words to indicate they were issued in place of others still outstanding. The certificates had originally been issued to Keller, who had pledged them as security. There was a conflict of testimony as to whether they were indorsed in blank or not; when the pledge had expired, they could not be found for redelivery. The company offered to issue a new certificate; marked "duplicate," and "issued in lieu of numbers 45, 46, 47 and 48, claimed to have been lost and unindorsed," upon Keller giving an indemnity bond of \$20,000. The court below ordered the company to issue the certificate without such words.]

THOMPSON, J. \* \* \* What, then, is a stock certificate? It is a solemn and continuing affirmation by the corporation that the person, to whom it was issued, is entitled to all the rights and subject to all the liabilities of stockholder in the company in respect of the number of shares named, and that the company will respect his rights, and the rights of any one to whom he may transfer such shares, by refusing to admit any new transferee to the rights of a shareholder except upon surrendering of the certificate. While it is not, in a strict sense, a negotiable instrument, yet it partakes to a great extent of the qualities of a negotiable security. Upon being indorsed by the original holder therein named, by signing a blank power of attorney, authorizing the person therein named to cause it to be transferred on the books of the corporation, it passes from hand to hand by delivery, very much as does a negotiable bond. When it falls into the hands of one, who buys not for speculation, but for investment, and who wishes to be admitted to the rights of a stockholder, he inserts a name in the blank power of attorney, and the person so empowered demands of the corporation the right to transfer it on the books of the company to the present holder. If this demand is refused, the holder has two remedies: First, an action against the corporation for damages for the conversion of his shares. *McAllister v. Kuhn*, 96 U. S. 87 (affirming s. c. 1 Utah 275); *Bank v. Lanier*, 11 Wall. (U. S.)

<sup>1</sup> Statement abridged; part of opinion of Thompson, J., and all of opinions of Rombauer, J., concurring, and of Biggs, J., dissenting, omitted.

369; Holbrook v. Zinc Co., 57 N. Y. 616; Payne v. Elliott, 54 Cal. 339, s. c. 35 Am. Rep. 80; Ayres v. French, 41 Conn. 142; Boylan v. Huguet, 8 Nev. 345; Bond v. Iron Co., 99 Mass. 505; Freeman v. Harwood, 49 Me. 195; Baltimore, etc., R. Co. v. Sewell, 35 Md. 238, s. c. 6 Am. Rep. 402; Pratt v. Railroad, 126 Mass. 443. Second, a suit in equity to compel the corporation to issue a new certificate to him and to admit him to the rights of a shareholder. Cushman v. Mfg. Co., 76 N. Y. 365, s. c. 32 Am. Rep. 315; Iron R. Co. v. Fink, 41 Ohio St. 321; Chew v. Bank, 14 Md. 299; St. Romes v. Press Co., 127 U. S. 614; Tel. Co. v. Davenport, 97 U. S. 369.

Both of these remedies necessarily proceed on the ground that the holder of the certificate is entitled to be admitted by the corporation to the rights of a shareholder, and that the corporation denies this right. The second remedy also proceeds upon the well-known principle that, in the eye of a court of equity, a corporation is a trustee for its shareholders for the purpose of protecting their rights as such.

Let us next inquire, with special reference to the facts of this case, what is the liability of the corporation where it issues a certificate of stock, which by its terms is transferable only on the books of the company, and then, on the representation of the person to whom it was originally issued that it has been lost or destroyed, issues to him another certificate, and he negotiates the latter to an innocent taker. It incurs the risk of a double liability in respect of the same shares. There are two adjudications on this point. In Greenleaf v. Ludington, 15 Wis. 558, the holder of a stock certificate assigned it, and then presented to the company an affidavit that he had lost it, and gave bond of indemnity and procured from the company a new negotiable one. Thereafter the holder of the original certificate demanded of the company a transfer of the title on its books to him, which the company refused. It was held that he could maintain an action against the company for damages. So, in Cleveland, etc., R. Co. v. Robbins, 35 Ohio St. 483, certain shares were transferred by the person named in the certificate to a *bona fide* purchaser in the usual way of signing the blank power of attorney indorsed on the certificate. Afterwards the company issued to a third party new certificates, on the supposition that the originals had been lost by the original holder. It was held that it must make good the damages to the *bona fide* transferee.

These cases, in what they hold, are consistent with the theory advanced by the court of appeals of New York in the celebrated Schuyler fraud cases, and no doubt held by other courts, that, in the case of an attempted *double* transfer of the same shares, the *bona fide* taker, to whom they are first transferred on the books of the company in the regular way, gets the title and is the shareholder. In the second of these cases it was said by Davis, J.: "Where the stock of a corporation is by the terms of its charter or by-laws transferable only on its books, the purchaser, who receives a certificate with power of attorney, gets the entire title, legal and equitable, as between himself and his seller, with all the rights the latter possessed; but, as

between himself and the corporation, he acquires only an equitable title, which they are bound to recognize and permit to be ripened into a legal title, when he presents himself, before any effective transfer on the books has been made, to do the acts required by the charter or by-laws in order to make a transfer. Until those acts be done, he is not a stockholder, and has no claim to act as such; but possesses, as between himself and the corporation, by virtue of the certificate and power, the right to make himself, or whomsoever he chooses, a stockholder by the prescribed transfer. The stock not having passed by the delivery of the certificate and power of attorney, the legal title remains in the seller, so far as affects the company and subsequent *bona fide* purchasers who take by transfer duly made on the books. And, hence, a buyer, in good faith, of the person in whose name the stock stands on the books, who takes a transfer in conformity to the charter or by-laws, permitted to be made by the authorized officer of the corporation, becomes vested with a complete title to the stock, and cuts off all the rights and equities of the holder of the certificate to the stock itself. What other rights and equities he may possess, is another question; but if the transferee has taken in good faith and for value, the stock is gone beyond his reach and beyond recall by the corporation. The non-production and surrender of the certificate at the time of the transfer is not fatal to the title of the transferee. It is only essential to the safety of the corporation, and may be waived by it at its own peril. The company has the means of knowing whether a certificate of particular stock is outstanding or not, and *the power to compel its return and cancellation*, before any transfer is made; and a buyer, where the transfer is permitted by the corporation to be made on its books by one to whose credit the stock is standing, has a right to presume that no certificate has issued, or, if one has, that his vendor has duly surrendered it for cancellation."

This reasoning contains the further suggestion, that to compel a corporation to issue a second original certificate in the place of one alleged to have been lost might put it in the hands of third persons to prejudice the rights of the public by imposing upon them as purchasers one or the other of these certificates. Both can not be good. The certificate is only the *symbol*, it is not the *stock*. There may be two certificates in respect of the same shares, but there can not be two sets of the same shares held in full ownership by two different persons, or by one person. If one certificate is good so as to confer the rights of a shareholder upon its owner, the other is void, except as giving an action for damages against the corporation. This is obvious when it is considered that the shares of the corporation can only be increased in the manner pointed out by its charter or governing statute, and not by the misprisions of its ministerial officers. Upon this ground it has been held that, if all the shares which the company is empowered to issue have been issued, and if other shares are thereafter issued, such excessive issue of shares is void, and does not even make their holders liable to creditors of the company. *Scovill v. Thayer*, 105 U. S. 143, 148, and cases cited. If, then, a corporation

can be compelled, on proof satisfactory to a court of equity and a bond of indemnity being given, to issue other original certificates in place of certificates claimed to have been lost, it may place in the hands of third parties the means of defrauding the public by conveying to them certificates of shares which do not give to them the rights of shareholders, but which only give to them the right to maintain a lawsuit against the company.

It is not necessary, for the purpose of this decision, for us to express an opinion, as to which of the certificate-holders, in such a case, would be entitled to the rights of stockholders as against the company. That question could only properly arise for determination in the contingency named, and we ought not to express an opinion upon it in this case, especially as no parties directly interested in determining it are before the court. It is sufficient for the purposes of this case for us to say that there are opposing theories on the subject. The New York doctrine, as shown by the language above quoted, is that the one whose transfer is first regularly made on the books of the corporation is the real stockholder. But, on the other hand, the supreme court of Illinois has held, in *Hall v. Road Co.*, 70 Ill. 673, that, if the secretary of a corporation issues new certificates of stock to one claiming to have purchased existing shares therein, without taking up and canceling the original, the new certificates will be *invalid*. Under this theory it is possible (though we do not so decide) that, if relief were granted in this case, as demanded by the plaintiff, a *bona fide* purchaser of the new certificates would get no rights as a shareholder, but only an action for damages against the corporation. Assuming that such a result is *possible*, it follows that any person to whom a certificate of corporate stock is offered for sale, which has been issued in lieu of another certificate still outstanding, has a right to know that fact. Upon what principle, then, shall a court of equity oblige a corporation to issue, in such a case as this, a new certificate concealing that fact? The concealment of such a fact by the holder from a purchaser might be such a fraudulent concealment as would avoid the sale. Can a court of equity make itself a party to such a fraudulent concealment?

It may be conceded, for the purposes of this case, that, where certificates of stock pass out of the hands of the original owner by theft, fraud, or even by accident, without negligence, a *bona fide* transferee, into whose hands they may subsequently come, will get no title which he can assert against the true owner, and none which he can oblige the corporation to recognize. *Biddle v. Bayard*, 13 Pa. St. 150; *Sherwood v. Meadow Valley, etc., Co.*, 50 Cal. 412. But, where he signs a blank indorsement of transfer, with an irrevocable power of attorney on the back of the certificate, and delivers it so signed to a third person, he not only voluntarily puts such third person in possession of the usual symbol of his property, but he also confers on him evidence of title, so that he may pass a good title to others, as against the original owner, to an innocent purchaser, although he has, in making the transfer to the innocent purchaser, proceeded in fraud of

the original owner and exceeded the authority actually conferred. *McNeil v. Bank*, 46 N. Y. 325, s. c. 7 Am. Rep. 341; *Merchants' Bank v. Livingston*, 74 N. Y. 223; *Mt. Holly, etc., Co. v. Ferree*, 17 N. J. Eq. 117; *Walker v. Railroad*, 47 Mich. 338. Assuming the soundness of these decisions, it follows that in this case the plaintiff, having voluntarily delivered the certificates to the bank cashier, indorsed in blank, as the cashier thinks, if the latter should transfer them to a third person for safe keeping, and that third person should wrongfully transfer them to an innocent taker, the plaintiff could not assert a title to them as against such innocent taker. If he could not assert a title to them as against an innocent purchaser, it would be on the ground that he had *parted with his title* to the latter; and, if he had parted with his title to the latter, it is not easy to see how he could *subsequently* transfer a good title to another by means of a new certificate issued by the corporation.

But as against the corporation the rights of the second purchaser, he being an innocent purchaser, would be at least such that he could maintain an action against the corporation for damages for refusing to transfer the shares to him on its books—and this wholly without reference to the rights of the preceding purchaser as against the corporation. This was ruled by the supreme court of the United States in *Bank v. Lanier*, 11 Wall. 369, 377, where certain *bona fide* purchasers of national bank shares sued the bank for damages for refusing to transfer the shares to them on their books. Mr. Justice Davis, in giving the opinion of the court, said: "The power to transfer their stock is one of the most valuable franchises conferred by congress upon banking associations. Without this power it can readily be seen the value of the stock would be greatly lessened; and, obviously, whatever contributes to make the shares of stock a safe mode of investment, and easily convertible, tends to enhance their value. It is no less to the interest of the shareholder than the public, that the certificate representing his stock should be in a form to secure public confidence; for without this he could not negotiate it to any advantage. It is in obedience to this requirement that stock certificates of all kinds have been constructed in a way to invite the confidence of business men, so that they have become the basis of commercial transactions in all the large cities of the country, and are sold in open market the same as other securities. Although neither in form nor character negotiable paper, they approximate to it as nearly as practicable. If we assume that the certificates in question are not different from those in general use by corporations, and the assumption is a safe one, it is easy to see why investments of this character are sought after and relied upon. No better form could be adopted to assure the purchaser that he can buy with safety. He is told, under the seal of the corporation, that the shareholder is entitled to so much stock, which can be transferred on the books of the corporation in person or by attorney, when the certificates are surrendered, but not otherwise. This is a notification to all persons interested to know, that whoever in good faith buys the stock, and produces to the corpo-



ration the certificates, regularly assigned with power to transfer, is entitled to have the stock transferred to him. And the notification goes further, for it assures the holder that the corporation will not transfer the stock to anyone not in possession of the certificates."

Without pursuing this line of inquiry further, we are clear that the company can not be involved in the double liability, which might follow from having two original certificates for the same shares outstanding, in the absence of any statute, by-law or conventional obligation putting such a liability on it, by the mere fact that one of its shareholders has, through his fault or misfortune, lost his original certificate, although suitable indemnity is given. If a second certificate, conveying no information on its face that it is a duplicate, is issued, and is negotiated to an innocent taker, it may find itself under a double liability in respect of the same shares. It may find that it has issued and received pay for one hundred shares, and that it is liable in respect of two hundred. By this act it may impair the value of the shares of every other stockholder in the company. Besides, if it can be required to do this in favor of one shareholder who has been so careless or unfortunate as to lose his certificates, it may be required to do so for all. In this way it may incur double liabilities, which may not mature for years, in respect of the same shares, against which it holds bonds of indemnity which may be good to-day and worthless to-morrow. Suppose that the new certificates have been negotiated to innocent takers, and in the meantime the bond of indemnity has become worthless; by what means can the corporation proceed to get a new and sufficient bond?

These suggestions show the difficulty in the way of granting the relief claimed by the plaintiff in this case. (Reviewing several cases.) \* \* \*

We are, therefore, of opinion that the decree of the circuit court must be reversed. We think that the most that can be required of the defendant is to issue to plaintiff duplicate certificates in lieu of the ones which have been lost. We are also of opinion that, if this is all that is required of the company, a bond of indemnity in the sum of \$1,000, signed by two solvent sureties will be sufficient. We direct the circuit court, if the plaintiff shall so move, to enter a decree requiring the defendant, on the plaintiff giving to it such a bond, to issue to him stock certificates in lieu of those which have been lost, bearing the same numbers, but containing the word "duplicate," written in red ink or conspicuously printed across their face; and also the following words, "Issued in pursuance of the decree of the circuit court of the city of St. Louis, state of Missouri, in the case of Henry Keller v. Eureka Brick Machine Co., being case numbered 81,263, on the docket of that court, in lieu of other certificates found by the court to have been accidentally lost and not negotiated by said Keller." It is so ordered. Judge Rombauer concurs; Judge Biggs dissents.

*Note.* See notes to following cases.

As to the implied warranties arising upon a sale of stock, see, 1900, *McClure v. Central Trust Co.*, 165 N. Y. 108, 53 L. R. A. 153 and note.

Sec. 556. (c) General limit on the right to transfer; transfers for purpose of evading liability.

NATIONAL BANK v. CASE.<sup>1</sup>

1878. IN THE SUPREME COURT OF THE UNITED STATES. 99 U. S. Rep. 628-635.

[Action by Case, receiver of the Crescent City National Bank, against the stockholders thereof, to enforce their statutory liability. Among the defendants against whom a decree was rendered was the Germania National Bank. The facts as to its ownership were: In 1872 it loaned to P., M. & Co. \$14,000, upon a pledge by the borrowers of 100 shares of stock in the Crescent bank, with power to sell the stock upon non-payment; a power was also given to the cashier to transfer the shares to the Germania bank. Default having occurred, the shares were transferred to the Germania bank, and immediately afterward transferred by the bank to Waldo, one of its clerks, there being an understanding that he should re-transfer it at their request. It was admitted that part of the reason for so doing was that in case of insolvency the bank would be liable as a shareholder if the stock was registered in its name.]

MR. JUSTICE STRONG. \* \* \* Such being the facts of the case, there can be no serious controversy respecting the principles of law applicable to them. It is thoroughly established that one to whom stock has been transferred in pledge or as collateral security for money loaned, and who appears on the books of the corporation as the owner of the stock, is liable as a stockholder for the benefit of creditors. We so held in *Pullman v. Upton* (96 U. S. 328); and like decisions abound in the English courts, and in numerous American cases, to some of which we refer: *Adderly v. Storm*, 6 Hill (N. Y.) 624; *Rosevelt v. Brown*, 11 N. Y. 148; *Holyoke Bank v. Burnham*, 11 Cush. (Mass.) 183; *Magruder v. Colston*, 44 Md. 349; *Crease v. Babcock*, 10 Metc. (Mass.) 525; *Wheelock v. Kost*, 77 Ill. 296; *U. S. Trust Co. v. U. S. Fire Ins. Co.*, 18 N. Y. 199; *Hale v. Walker*, 31 Iowa 344. For this several reasons are given. One is, that he is estopped from denying his liability by voluntarily holding himself out to the public as the owner of the stock, and his denial of ownership is inconsistent with the representations he has made; another is, that by taking the legal title he has released the former owner; and a third is, that after having taken the apparent ownership and thus become entitled to receive dividends, vote at elections, and enjoy all the privileges of ownership, it would be inequitable to allow him to refuse the responsibilities of a stockholder. This subject is well treated in Mr. Thompson's recently published work on "The Liability of Stockholders," where may be found not only a full collection of authorities, but a careful analysis of what the authorities contain. *Vide* ch. 13.

When, therefore, the stock was transferred to the Germania bank,

<sup>1</sup> Statement abridged; only part of opinion given.

though it continued to be held merely as a collateral security, the bank became subject to the liabilities of a stockholder, and the liability accrued the instant the transfer was made. At that instant the liability of Phelps, McCullough & Co. ceased. We have, then, only to inquire whether the bank succeeded in throwing off that liability by its transfer to its clerk, Waldo. It certainly did not thereby divest itself of its substantial ownership. It is not every transfer that releases a stockholder from his responsibility as such. While it is true that shareholders of the stock of a corporation generally have a right to transfer their shares, and thus disconnect themselves from the corporation and from any responsibility on account of it, it is equally true that there are some limits to this right. A transfer for the mere purpose of avoiding his liability to the company or its creditors is fraudulent and void, and he remains still liable. The English cases, it is admitted, give effect to such transfers, if they are made (as it is called) "out and out;" that is, completely, so as to divest the transferrer of all interest in the stock. But even in them it is held that if the transfer is merely colorable, or, as sometimes coarsely denominated, a sham,—if, in fact, the transferee is a mere tool or nominee of the transferrer, so that, as between themselves, there has been no real transfer, "but in the event of the company becoming prosperous the transferrer would become interested in the profits, the transfer will be held for nought, and the transferrer will be put upon the list of contributories." Williams's Case, Law Rep. 9 Eq. 225, note, where the transfer was, as in the present case, made to a clerk of the transferrer without consideration; Payne's Case, Law Rep. 9 Eq. 223; Kintrea's Case, Law Rep. 5 Ch. 95. See, also, Lindley on Partnership (2d ed.), p. 1352; Chinnock's Case, 1 Johns. (Eng.) Ch. 714; Hyam's Case, 1 De G., F. & J. 75; Budd's Case, 3 De G., F. & J. 297. The American doctrine is even more stringent. Mr. Thompson states it thus, and he is supported by the adjudicated cases: "A transfer of shares in a failing corporation, made by the transferrer with the purpose of escaping his liability as a shareholder, to a person who, from any cause, is incapable of responding in respect to such liability, is void as to the creditors of the company and as to other shareholders, although as between the transferrer and the transferee it was out and out." Nathan v. Whitlock, 9 Paige (N. Y.) 152; McClaren v. Franciscus, 43 Mo. 452; Marcy v. Clark, 17 Mass. 330; Johnson v. Laflin, by Dillon, J., 5 Dill. 65, 6 Cent. Law Jour. 124.

The case in hand does not need the application of so rigorous a doctrine. While the evidence establishes that the Crescent City was in a failing condition when the transfer to Waldo was made, and leaves no reasonable doubt that the Germania bank knew it and made the transfer to escape responsibility, it establishes much more. The transfer was not an out-and-out transfer. The stock remained the property of the transferrer. Waldo was bound to re-transfer it when requested, and all the privileges and possible benefits of ownership continued to belong to the bank. No case holds that such a transfer relieves the transferrer from his liability as a stockholder. We are,

therefore, compelled to rule that the decree of the circuit court against the Germania bank was correct. Its case, no doubt, is a hard one; but it is not in our power to give relief, without a sacrifice of the well-established rules of law and equity both in this country and in England. \* \* \*

*Affirmed.*

*Note. Accord:* 1838, Nathan v. Whitlock, 3 Edw. Ch. 215; 1895, Coleman v. Howe, 154 Ill. 458, 471, 45 Am. St. Rep. 133; 1896, Burt v. Real Estate Ex., 175 Pa. St. 619, 52 Am. St. Rep. 858; 1898, Sprague v. National Bank, 172 Ill. 149, 64 Am. St. Rep. 17; 1900, Wick Natl. Bk. v. Union Natl. Bk., 62 Ohio St. 446, 57 N. E. Rep. 320; 1900, Ward v. Joslin, 100 Fed. Rep. (C. C. N. H.) 676. See 1901, Earle v. Carson, 107 Fed. 639, 46 C. C. A. 498, 60 L. R. A. 266.

The English rule is otherwise: 1859, De Pass's Case, 4 DeG. & J. 544; 1880, Chynoweth's Case, L. R. 15 Ch. D. 13; 1883, In re Taurine Co., L. R. 25 Ch. D. 118. See Cook Corp., sections 263-266.

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**Sec. 557. (d) Fraud, forgery, etc.**

See East Birmingham L. Co. v. Dennis, 85 Ala. 565, *supra*, p. 807; Keller v. Eureka Brick Machine, etc., Co., 43 Mo. App. 84, *supra*, p. 1655; McNeil v. Tenth Natl. Bk., 46 N. Y. 325, *infra*, p. 1674.

*Note* See, 1721, Monk v. Graham, 8 Mod. 9; 1722, Hilyard & South Sea Co. v. Keate, 2 P. Wms. 76; 1765, Ashby v. Blackwell, etc., Bank, Ambler 503; 1879, Simm v. Anglo-Am. Tel. Co., 5 Q. B. Div. 188; 1879, Machinists' Bank v. Field, 126 Mass. 345; 1883, Boston & Alb. R. v. Richardson, 135 Mass. 473; 1889, Allen v. So. Boston R., 150 Mass. 200; 1900, Phil. Natl. Bk. v. Smith, 195 Pa. St. 38, 45 Atl. Rep. 655.

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**Sec. 558. (e) Registration of transfers upon corporate books —theories as to the necessity of.**

(1) Not necessary; attaching creditors of seller.

**BROADWAY BANK v. McELRATH ET AL.**

1860. IN THE COURT OF CHANCERY OF NEW JERSEY. 13 N. J. Eq. Rep. 24-31.

**THE CHANCELLOR (GREEN).** The property which forms the subject of controversy consists of fifty shares of the capital stock of the Trenton Iron Company, of the par value of one hundred dollars each, standing on the books of the company in the name of McElrath. On the 2d of June, 1854, the certificate of the stock, accompanied by a power of attorney irrevocable for the transfer thereof, was delivered to the Broadway Bank, as collateral security on a loan of four thousand dollars, obtained by McElrath from the bank,

upon his individual note, at four months. The loan was made upon the agreement of McElrath to deposit the stock as a collateral security for the repayment of the loan, including as well the original note as all renewals thereof. The note was renewed, and the accruing interest paid, from time to time, until the 22d of November, 1857, when the last renewal was made.

On the 24th of August, 1857, the Hunterdon County Bank sued out of the supreme court of this state a writ of attachment against the estate of the said McElrath, as a non-resident debtor, by virtue of which the stock in question was attached as the property of McElrath. Judgment having been rendered in favor of the plaintiff in attachment, and also in favor of sundry applying creditors, the auditors in attachment were proceeding to make sale of the stock in question, to satisfy those judgments, when they were restrained by an injunction issuing in this cause. The complainants insist that they have an equitable lien upon the stock for the payment of the debt for which it was hypothecated as security. The defendants claim that they have acquired a valid title to the stock at law and in equity by virtue of the attachment.

The stock, irrespective of the complainants, was, undoubtedly, under the provisions of the statute, the subject of attachment. The judgment at law has established the claims of the plaintiff and the applying creditors in attachment. The validity of the proceedings under the attachment, is not drawn in question. The defendant's right to the property is unquestioned, except so far as it conflicts with the prior rights of the complainants.

By the fifth section of the charter of the Trenton Iron Company, approved February 16, 1847 (Pamph. Laws 61), it is enacted that "the capital stock of the said corporation shall be deemed personal estate, and be transferable upon the books of the said corporation;" and by the ninth section of the charter it is further enacted "that books of transfer of stock shall be kept, and shall be evidence of the ownership of said stock in all elections and other matters submitted to the decision of the stockholders of the said corporation."

Independent of the provisions of the charter, the stock of an incorporated company is deemed personal estate, and may be transferred by a certificate of stock, accompanied by a power of transfer. Angell & Ames on Corp., section 564.

And where it is provided, by the charter or by-laws, that the stock shall be transferred only upon the books of the corporation, there is a decided weight of authority in support of the position that a *bona fide* transfer, by delivery of the certificate, is, nevertheless, valid as between vendor and vendee, that the equitable title passes by such transfer, and that the claim of the vendee is good, in equity, against the claim of an execution or attaching creditor of the vendor. Such provision, whether by charter or by-law, is regarded as designed to protect the interests of the corporation, and as applying solely to the relation between the corporation and its stockholders. Its only office is held to be equivalent to that of the provision contained in the ninth

section of the charter of the Trenton Iron Company, viz., "to afford evidence of the ownership of the stock, in all elections and other matters submitted to the decision of the corporation," including all questions as to the ownership of the stock as between the corporation and its members. Angell & Ames on Corp., 354; Bank of Utica v. Smalley, 2 Cowen 770; Gilbert v. Manchester Iron Co., 11 Wend. 627; Kortright v. Buffalo Commercial Bank, 20 Wend. 91; same case in error, 22 Wend. 348; Quiner v. Marblehead Insurance Co., 10 Mass. 476; Union Bank of Georgetown v. Laird, 2 Wheat. 390; 3 Howard 513; Stebbins v. Phoenix Fire Insurance Co., 3 Paige 350, 3 Binney 394; Grant v. Mechanics' Bank, 15 Serg. & R. 140; Bank of Kentucky v. Schuylkill Bank, 1 Parsons (Pa.) Sel. Cas. 180, 247; United States v. Cutts, 1 Sumner 133.

There is not an entire uniformity of authority upon the question whether a transfer or pledge of stock as collateral security without a transfer upon the books of the company, as required by the charter, will protect the holder against the claims of an attaching creditor, though the weight of authority is decidedly in favor of the right of the assignee.

It is the well-settled rule in New York, where this contract was made, and where the contracting parties had their domicile at the time of the contract, and the pledge of the stock by McElrath to the bank.

It was so expressly decided in this state long prior to the date of that contract. Rogers et al. v. Stevens, 4 Halst. Ch. 167.

So far as judicial determination could settle the question, it was settled prior to the pledge of this stock, both in the state where the contracting parties had their domicile and in the state where the corporation whose stock was transferred was chartered and transacted its business. The parties to the contract may fairly have relied upon the law, as thus settled, for the protection of their rights. It is of the utmost importance that questions so extensively and vitally affecting the rights of the business community should be regarded as settled by judicial decision, and not liable to be disturbed, except for the most cogent reasons. Upon the faith of decisions already made upon this very point, contracts have doubtless been entered into and securities taken to a very large amount. Whatever might be my conclusion as to the true construction of the statute, were the question now for the first time agitated, it would be alike unwise and unjust to overturn or impair rights acquired upon the faith of recognized legal principles.

I think it clear, moreover, whatever might be the strict legal interpretation of the provision in question, that the legislature never designed it to impair the validity of a transfer of stock, as between the parties making it. It was not intended to introduce a new mode of acquiring title to stocks, much less to operate as a registry law, by furnishing conclusive evidence to the public of the ownership of the property. If such had been the design, it might have been expected that the legislature would have required that the books of transfer should be at all times open to public inspection, and the record, not



in certain specified cases merely, but in all cases, made evidence of ownership.

Nor does sound policy require such construction to be given to the act. The pledge of stocks as collateral security has become a prevalent, and to the borrower, especially, an advantageous mode of effecting loans. In manufacturing companies especially, where the business of the company is carried on by the stockholder, and where his capital is mainly or exclusively vested in the stock, and employed in the active operations of business, the pledge of stocks affords the most ready and advantageous mode of effecting loans for the demands of business. To require a transfer of the stocks to the lender as security for the loan against the right of attaching or execution creditors will at once destroy the value of the security, or compel the borrower to divest himself of his character as corporator to forfeit his control of the business of the corporation, of his right to dividends, and of all his other rights as a stockholder in the corporation. Why should the owner of stocks be deprived of the privilege of mortgaging or pledging his stock for the security of a loan without stripping himself of all his rights of ownership more than the owner of any other property?

The objection is, that it will open the door to fraud and deprive an execution or attaching creditor of the means of ascertaining the real ownership of the stock. It is worthy of notice that this clause requiring a transfer of stock on the books of the company was inserted in numerous charters long before the stock was made the subject of execution. But the objection, as applied to a transfer of stock, is of less weight than against a chattel mortgage, the chattel remaining in the hands of the mortgagor, which is held to be a valid security. *Runyon v. Groshon*, 1 Beasley 86.

The transfer book is not the only evidence of the ownership of stock. The certificate, which has always been deemed *prima facie* evidence of ownership, is the only evidence in possession of the owner, and where there has been no transfer, is the only recognized evidence of title.

It is urged that the contract for the pledge of this stock was executory merely; that it does not purport to transfer the ownership of the shares, but simply gives an authority to transfer upon failing to pay the debt; and hence it is further argued that the stock can not be held as a pledge because that requires a transfer of possession. The contract between the parties was in no sense executory. It was fully executed according to the intention of the parties. The absolute ownership of the stock, it is true, was not transferred, nor was it intended it should be. The spirit and design of the contract was that the legal ownership of the stock should continue in McElrath; that he should remain a member of the corporation, with the right to receive the dividends upon the stock, to vote at all elections, and with all other rights pertaining to him as a stockholder and member of the company, and that the bank should hold the stock as collateral security for the payment of the loan, with the absolute and irrevoca-

ble right of transferring the legal ownership upon failure to pay the debt. The same objection existed in many of the reported cases where the right of the party holding the certificate of stock as evidence of his claim was sustained against the claims of attaching or execution creditors. 3 Binney 394; 4 Halst. Ch. 167.

Such a certificate annexed to or accompanying a blank power of attorney, we can not doubt, not only according to the understanding of men in business, but upon well-settled principles of law, passes by delivery an equitable title to a *bona fide* purchaser; nor can such purchaser be justly prevented from converting his equitable into a legal title by filling up and exercising the power, whenever he is entitled to do so by the nature and terms of the contract under which the certificates were delivered to him. When the stock is sold absolutely his right then to perfect his title is immediate; when it is hypothecated, the right accrues when the debt meant to be secured becomes due and remains unpaid. Per Ackley, C. J., in *Fatman v. Lobach*, 1 Duer 354, 361.

It is obvious, moreover, that so far as regards the legal ownership of the stock, if the transfer upon the books of the company alone can constitute legal ownership, that the contract of sale is as fully executed by delivering the certificate, with the power of immediate transfer on the books of the company, as by a formal assignment accompanying the certificate.

The holder of a certificate of shares of stock, accompanied by an irrevocable power of attorney to transfer them, is the apparent owner, and when he is the holder for value without notice his title can not be impeached. *Leavitt v. Fisher*, 4 Duer 1.

Aside from the general principles by which, I think, the case must be controlled, it is worthy of notice that the charter of the company, the stock of which is here the subject of controversy, is somewhat variant from many of those which have formed the subject of adjudication. In the case of *Fisher v. The Essex Bank*, 5 Gray 373, the act of incorporation declared that the stock of the bank should be transferable *only* at its banking-house and on its books. The court say that the word "only" carries an implication as strong as negative words could make it, that the transfer should be in no other mode. It was not to prescribe one mode, leaving others unaffected; it made that mode exclusive. The charter of the Trenton Iron Company contains no such exclusive language. It declares merely that the stock shall be transferable on the books of the company, and further provides that the books of transfer shall be evidence of ownership, as between the company and its stockholders. If the transfer on the books was designed to be the only evidence of ownership, the latter provision would seem to be unnecessary.

The right of the bank is in no wise prejudiced by the fact that they appeared as applying creditors under the attachment, and presented their claim to the auditors.

The *bona fides* of their claim is not questioned, and they are entitled to the stock in question clear of the lien of the attachment.

*Decree accordingly.*

*Note.* See note at end of next case.

Sec. 559. Same. (2) Registration is necessary; attaching creditors of seller.

FISHER v. ESSEX BANK.<sup>1</sup>

1855. IN THE SUPREME JUDICIAL COURT OF MASSACHUSETTS. 5  
Gray (Mass.) Rep. 373-383.

[Action by Fisher to recover damages for the bank's refusal to transfer forty shares of its stock to plaintiff. The shares stood in the name of one Bingham, from whom the plaintiff purchased them February 26, 1852, receiving the certificate therefor, duly assigned with a power of attorney in blank to have them transferred upon the books of the bank. April 13, Fisher wrote the president of the bank that he had the forty shares, with power of attorney from Bingham, and which he was authorized to sell, and asked his assistance, saying Bingham was absent for a few days, but would probably be home by the time an answer was received, and saying the stock would then be forwarded, if the price was satisfactory. May 10, an attorney of the plaintiffs presented to the bank the certificates with the power of attorney, and demanded a transfer; the bank refused, because the shares had been attached as the property of Bingham. After all the evidence was in, by agreement, a verdict *pro forma* for plaintiff was taken, and the case reported to the whole court.]

SHAW, C. J. \* \* \* Shares in incorporated companies, such as banks, insurance companies, bridges, turnpikes and railroads, have long been considered in this commonwealth as property of a definite and important character, with many of the qualities of visible, tangible, personal property, and having a value, and as capable of appreciation as vessels, or merchandise, or other personal chattels. But it is not visible or tangible, and therefore not like merchandise, capable of passing by manual delivery.

A nearer analogy, perhaps, is that of a chose in action, capable, like this, of being assigned in equity, by a delivery over of the certificate, which is the assignor's muniment of title, with an assignment duly executed, transferring to the assignee all the assignor's right, title and interest. And yet it is not like the assignment of a chose in action, which is the transfer of the assignor's interest in a debt, and vests in the assignee an equitable right to collect the debt in the name of the assignor.

The right is, strictly speaking, a right to participate, in a certain proportion, in the immunities and benefits of the corporation; to vote in the choice of their officers, and the management of their concerns; to share in the dividends of profits, and to receive an aliquot part of the proceeds of the capital, on winding up and terminating the active existence and operations of the corporation. Again: when a transfer is rightfully made and completed, it vests a right in the transferee,

<sup>1</sup> Statement abridged; part of opinion omitted.

not merely to act in the place of the vendor and in his name, but substitutes him, in all respects, as the legal and only holder of the shares transferred, to the same extent to which they were before held by the vendor. The title, therefore, by which such interest is held, is strictly a legal title; it is created and defined by law; its benefits are secured by law; it is transferable by operation of law, and may be attached on mesne process and seized on execution, and sold by legal authority to satisfy the debts of the owner.

Before any method was established by positive law, how, by what mode, or by what precise and definite act, such property should be considered as ceasing to be the property of the seller and becoming the property of the purchaser, courts of justice might well resort to the common law modes of transferring similar incorporeal interests, and hold that a delivery of the only muniment of title held by the owner, with the execution and delivery of an assignment of his interest, by indorsement on the certificate or otherwise, should by analogy be held to be a valid transfer, and, when notified to the bank, should be considered as having taken effect at the date of such delivery.

But whatever common law rules courts may have felt bound to adopt, in the absence of any express rule of law, in determining what act constitutes the actual transfer of shares, the point of time at which the one alienates and the other acquires a legal title to such shares, we can perceive no room to doubt that, where it is so regulated, such law must govern. In the present case there is such an express provision in the act of incorporation itself. The bank is of recent origin, the act was passed in 1851. Sts., 1851, ch. 269. Like most other modern acts of incorporation, the act, after creating the corporation, giving it a name, fixing its location and limiting its capital stock, defines its powers and duties by reference to other acts on the subject. But section 3 is a special provision to this effect: "The stock of said bank shall be transferable only at its banking house and on its books." By the law of this commonwealth, acts of incorporation are deemed public acts. Rev. Sts., ch. 2, section 3. Like other public acts of legislation, their provisions constitute laws, by which all courts and magistrates, all citizens and subjects are bound.

But it was strongly urged, in the learned argument for the plaintiffs in this case, that this provision in the charter can have no greater force and effect than a by-law of the corporation in the same terms, and does not make a transfer on the books of the bank necessary to pass the title. There is something in one New York case which countenances this suggestion; but perhaps it originated in the peculiar provisions of the New York statutes. If the corporation are fully authorized to make by-laws, regulating the transfer, there would seem to be some ground for holding that they would be binding upon those holding or seeking to hold shares in the same corporation. If a by-law would have the same effect, then it is unnecessary to make the distinction between a by-law binding upon corporators, and all those claiming to stand in relation of corporators, and a general law of the

commonwealth binding on all its subjects. But if there be such a distinction, then here is a law of the commonwealth binding upon all.

But the argument goes further, and insists that the transfer at the bank is not essential to transfer the property to a *bona fide* purchaser, but is merely a regulation for the convenience and protection of the bank.

We can see no ground upon which thus to restrict the plain provision of the statute. If we may judge of the intended operation of an act of legislation from the useful and beneficial purposes it may tend to promote, we should construe it as having a much broader and more comprehensive scope. We are to take it in connection with all other existing laws.

As a great amount of property is held in Massachusetts in the shares of corporations, it is of importance that the title be easily and certainly ascertained, that the mode of acquiring and alienating it be fixed and known, and that it may at any time be made available, by process of law, for the debts of the owner.

In no way can these objects be so well effected as by a transfer at the bank. The law might have provided that the bearer of the certificate should be deemed the holder, so that it might pass from hand to hand by mere manual delivery. But this would be attended with almost inextricable difficulty. It would be impossible for officers and co-proprietors to know who their associates were, and at every meeting nothing could be done till those present should produce their certificates, and thus show who were entitled to vote; and even then, certificates might change owners during the meeting. The shares could never be attached; for the officer could have no means to obtain possession of the certificate from a reluctant debtor adversely interested; and, without it, the shares might pass the next day to a purchaser without notice.

2. The certificate, in the form now given, may show who is the legal owner at the date of its issue, but this outstanding certificate may have been loaned, pledged, assigned in equity, which it is now contended would, as between the parties, be a good and valid transfer. It can not therefore be known, by the books of the bank, who is proprietor at any one time.

3. It is obviously an object of great importance, that this large amount of property should be attachable and liable to be sold on execution. This has long been the policy of the state by earlier statutes, ultimately embraced in the Rev. Sts. ch. 90, section 36; ch. 97, sections 36 *et seq.* The certificate being in the hands of the debtor, or some other person on his account, and his interest being adverse to that of the attaching creditor, the officer could seldom, if ever, take possession of it as of a chattel. It is therefore provided that the attachment may be effected by leaving written notice at the bank; and, on a sale on execution, it is made the duty of the bank and its officers, on notice and request, to give the purchaser a new certificate. This of necessity supersedes the outstanding certificate to the former holder.

All these objects are most effectually accomplished by making the transfer at the bank the decisive act of passing the property, the legal transferable, attachable interest. I do not stop to ask precisely what particular act would constitute such a transfer; whether it must be actually entered on the books, or whether the delivery of the certificate by the holder ready to transfer, or with a written transfer executed, so that nothing remains but the mere executive act of the clerk, is sufficient. In either case it would show who is at any time the actual owner by the books, and inform a creditor, or other person having occasion to know and right to inquire. It is necessary to fix some act, and some point of time, at which the property changes and vests in the vendee; and it will tend to the security of all parties concerned to make that turning point consist in an act which, whilst it may be easily proved, does at the same time give notoriety to the transfer. It would seem to us to be going beyond the rules of just exposition, to hold that a plain provision of statute law, calculated to promote the security of important legal rights of parties in important particulars, should be construed to be a regulation made for the convenience and protection of banks. The clause itself is too clear to admit of doubt: "Shall be *transferable* only," that is, capable of being transferred; the largest and broadest term to express alienation on one part and acquisition on the other; and the word "only" carries an implication as strong as negative words could make it, that is, in no other mode. It was not to prescribe one mode, leaving others unaffected; it made that mode exclusive.

Nor is this position without high authority to support it. In *Union Bank v. Laird*, 2 Wheat. 390, it was held by the supreme court of the United States that, where shares were, by the act of incorporation, made transferable on the books, no person could acquire a legal title in any other mode.

The early Massachusetts cases cited for the plaintiffs, such as *Dix v. Cobb*, 4 Mass. 508, were mere equitable assignments of choses in action, and held valid as equitable assignments.

*Quiner v. Marblehead Social Ins. Co.*, 10 Mass. 476, was the case of a new corporation, the full amount not paid in, no certificates to proprietors issued, but certain installments had been paid in by subscribers, for which receipts had been given. The act of incorporation provided that no transfer should be valid till the stock was all paid in. It was held that an assignment of these certificates, with power to complete the payment in the name of the assignor, was a good assignment in equity. Besides, there does not appear to have been any clause in the charter or by-law directing how shares should be transferred when the company should be organized and in operation.

In the case of *Sargent v. Franklin Ins. Co.*, 8 Pick. 90, the old certificate, together with an executed assignment of the shares, was tendered to the secretary of the company at their office in business hours, with a power of attorney to transfer on the books, and a new certificate was demanded. This was a full compliance with the by-law on



the part of the purchasers; it was the duty of the company then to enter the assignment, and they could not set up their own wrongful act in refusing to enter the transfer, and an attempt to attach the shares themselves, in their own defense. The reasoning of the court may have gone further in stating the grounds, but these were amply sufficient to warrant the adjudication.

The case of *Sergeant v. Essex Marine Railway*, 9 Pick. 202, is much nearer the present case, and, so far as the requirement that the transfer be made at the bank rests on a mere by-law, is in point. The by-law required that all transfers be made in a book, in a specific form, and transferable only on the books. The court consider this by-law, requiring a transfer in a particular form on the books of the bank, as an arrangement of the corporation for their own convenience. But they add: "Neither the act of incorporation, nor any other statute, requires that an assignment shall be recorded in order to give it validity." 9 Pick. 205. This seems to carry a clear implication that if any provision of law, binding on all persons as such, had required it to be recorded, it must be entered in the books, or delivered to the proper officer for record, to give it validity.

We are aware that several of the New York cases cited in the argument are decisions contrary to the rule we now adopt. But it is to be remarked that, in the case of *Commercial Bank of Buffalo v. Kortright*, 22 Wend. 348, before the court of errors, the chancellor and a respectable minority of the members of the court dissented on this point, and were of opinion that, when the charter contains a provision that no transfer shall be valid unless registered in the books, an unregistered transfer does not convey a legal title, but an equitable interest only, subject to all prior equities.

And we think the authority of the case in New York is more than counterbalanced by the decisions of several of the neighboring states.

In Vermont, the court says: "We entertain no reasonable doubt that the mode of transfer of stock pointed out in the charter is the only mode which the public are bound to regard as conveying the title. All persons, unaffected with notice to the contrary, are at liberty to act upon the faith of the title being where it appears upon the books of the corporation to be." *Sabin v. Bank of Woodstock*, 21 Vt. 353.

In Connecticut, there are several cases precisely in point. The question of actual transfer is considered to be a question of legal title; and in all transfers under such charter and by-law, the change of title is held to take place when the instrument of transfer is received for record by the clerk, and the transfer bears date from that time. *Oxford Turnpike Co. v. Bunnell*, 6 Conn. 552.

In the present case, it is insisted that the plaintiffs presented the certificate, with a transfer from Bingham, and demanded a transfer before the sale on execution. This is true; but the attachment on mesne process was made before any such notice given and demand made by the plaintiffs; and the title of the attaching creditor relates back to the time of attachment. We are of opinion, therefore, that

the attachment and subsequent sale gave that purchaser the better legal title.

*Plaintiffs nonsuit.*

*Note.* The cases are in conflict as to the necessity of having transfers registered upon the corporate books in order to pass the title to the shares of stock. Perhaps the general rules can be stated: (1) The corporation, when it has no knowledge to the contrary, can rely upon its records in paying dividends, etc. (2) Creditors can rely upon the corporate records and hold those whose names there appear to any shareholder's liability. (3) As between seller and purchaser alone, the delivery of the certificate properly indorsed, without registration on the corporate books, passes the title. (4) As to attaching creditors of the seller, delivery of certificate properly indorsed (by one line of authority), is sufficient to give the purchaser, before registration, a better title than the attaching creditor; another line of authorities holds the contrary. (5) A shareholder whose certificate has been lost without negligence, or has been stolen, is not divested of his title, even though it was indorsed in blank, and a *bona fide* purchaser obtains registration in his name on the corporate books. (6) It is the duty of the corporation and of the purchaser generally to see that the old certificate is surrendered when a new one is issued in place of an old one. (7) If the corporation issues a new one without the old being surrendered, it becomes liable upon both outstanding certificates to good faith holders thereof. (8) A purchaser who does not exercise reasonable care to see that the old certificate is surrendered, when the transfer is made to him upon the corporate books, is not a *bona fide* purchaser as against the rightful holder of the certificate of stock; but see, 1903, *Havens v. Bank of Tarboro*, 132 N. C. 214, 95 Am. St. R. 627; and (9) it seems that where each of two purchasers is in every respect a *bona fide* purchaser, the one who relies upon the register, and in good faith gets the transfer made to him upon the books of the company, gets a better title than the *bona fide* holder of the certificate alone; and (10) when the owner of shares places them in the hands of others in such way as to apparently clothe them with full power to transfer the same as their own and they do so to a *bona fide* purchaser, he gets a good title which the original owner is estopped to question.

The following cases, under various circumstances, and for different purposes, have held that *registration upon the corporate books is essential*: 1818, *Marlborough Mfg. Co. v. Smith*, 2 Conn. 579; 1839, *Coleman v. Spencer*, 5 Blackf. 197; 1845, *Black v. Zacharie*, 3 How. 483; 1861, *Pinkerton v. Railroad Co.*, 42 N. H. 424; 1885, *Lippitt v. Am. Wood Paper Co.*, 15 R. I. 141; 1887, *Fort Madison Lumber Co. v. Batavian Bank*, 71 Ia. 270; 1898, *McFall v. Buckeye Grangers, etc., Co.*, 122 Cal. 468, 68 Am. St. Rep. 47; 1898, *Sprague v. National Bank*, 172 Ill. 149, 64 Am. St. Rep. 17; 1898, *Russell v. Easterbrook*, 71 Conn. 50, 40 Atl. Rep. 905; 1898, *Parker v. Carolina Sav. Bank*, 53 S. C. 583, 31 S. E. Rep. 673; 1900, *Giesen v. London & N. W., etc., Co.*, 102 Fed. Rep. 584; 1900, *Perkins v. Lyons*, 111 Ia. 192, 82 N. W. Rep. 486.

The following hold that *registration upon the corporate books is not essential to the transfer*: 1845, *St. Louis Ins. Co. v. Goodfellow*, 9 Mo. 149; 1850, *Biddle v. Bayard*, 13 Pa. St. 150; 1875, *Sherwood v. Meadow Valley, etc., Co.*, 50 Cal. 412; 1880, *Boston Music Hall Assn. v. Cory*, 129 Mass. 435; 1881, *Continental Nat'l Bank v. Eliot Nat'l Bank*, 7 Fed. Rep. 369; 1892, *Gemmell v. Davis*, 75 Md. 546; 32 Am. St. Rep. 412; 1892, *Lund v. Wheaton R. Co.*, 50 Minn. 36; 1895, *Allen v. Stewart*, 7 Del. Ch. 287, 44 Atl. Rep. 786; 1895, *Hotchkiss & U. Co. v. Union National Bank*, 37 U. S. App. 86; 1896, *Spreckles v. Nevada Bank*, 113 Cal. 272, 54 Am. St. Rep. 348; 1896, *Meredith Village Sav. Bank v. Marshall*, 68 N. H. 417, 44 Atl. Rep. 526; 1899, *Bates-Farley Sav. Bank v. Dismukes*, 107 Ga. 212, 33 S. E. Rep. 175; 1899, *Masury v. Ark. Natl. Bank*, 93 Fed. Rep. (C. C. A. Ark.) 603; 1900, *Batesville Tel. Co. v. Myer, etc., Co.*, 68 Ark. 115, 56 S. W. Rep. 784; 1900, *State v. Whited & Wheless*, 104 La. 125, 28 So. Rep. 922.

*Attachment of shares:*

(a) *Where*: See, 1858, *Evans v. Monot*, 4 Jones Eq. (N. C.) 227; 1883, *Plimpton v. Bigelow*, 93 N. Y. 592, *supra*, p. 811; 1886, *Winslow v. Fletcher*, 53 Conn. 390, 13 Am. & E. C. C. 39; 1892, *Armour & Co. v. St. L., etc., Co.*, 113 Mo.

12, 20 S. W. Rep. 690; 1893, *Smith v. Downey*, 8 Ind. App. 179, 52 Am. St. Rep. 467, note 474; 1895, *Ireland v. Globe Milling Co.*, 19 R. I. 180, 61 Am. St. Rep. 756, 29 L. R. A. 429; 1900, *Simpson v. Jersey City, etc., Co.*, 165 N. Y. 193, 58 N. E. Rep. 896.

(b) *How*:

Attaching creditor of seller who properly notifies corporation before transfer is registered gets better title to the shares than the purchasing certificate-holder: 1860, *Skowhegan Bank v. Cutler*, 49 Me. 315; 1861, *Pinkerton v. Railroad Co.*, 42 N. H. 424; 1877, *Chesapeake & O. R. v. Paine*, 29 Gratt. (Va.) 502; 1882, *Shenandoah V. R. v. Griffith*, 76 Va. 913; 1885, *Lippitt v. Am. Wood Paper Co.*, 15 R. I. 141; 1887, *Fort Madison L. Co. v. Batavian Bank*, 71 Iowa 270; 1890, *Conway v. John*, 14 Colo. 30, 23 Pac. Rep. 170; 1891, *Wilson v. St. Louis, etc., R.*, 108 Mo. 588, 18 S. W. Rep. 286; 1900, *Fahrney v. Kelly*, 102 Fed. Rep. (C. C. Ark.) 403.

*Contra*: Transferee gets better title without registration: 1860, *Broadway Bank v. McElrath*, 13 N. J. Eq. 24, *supra*, p. 1663; 1873, *Smith v. Am. Coal Co.*, 7 Lans. (N. Y.) 317; 1880, *Boston Music Hall Assn. v. Cory*, 129 Mass. 435; 1880, *Eby v. Guest*, 94 Pa. St. 160; 1881, *Continental Natl. Bk. v. Eliot, etc., Bk.*, 7 Fed. Rep. 369; 1888, *Telford, etc., Tp. Co. v. Gerhab (Pa.)*, 13 Atl. Rep. 90; 1892, *Doty v. First Nat'l Bk.*, 3 N. Dak. 9, 53 N. W. Rep. 77; 1892, *Lund v. Wheaton*, 50 Minn. 36, 52 N. W. Rep. 268; 1892, *Cooper v. Griffin*, 66 L. T. Rep. 660; 1893, *Kern v. Day*, 45 La. 71, 12 So. Rep. 6; 1901, *McClung v. Colwell*, 107 Tenn. 592, 89 Am. St. R. 961.

## Sec. 560. Same. (3) Fraudulent transfer by pledgee.

### McNEIL v. TENTH NATIONAL BANK.<sup>1</sup>

1871. IN THE NEW YORK COURT OF APPEALS. 46 N. Y. Rep. 325-340.

[Action to compel a surrender of shares of stock. Plaintiff was the owner of 134 shares of stock in the First National Bank of St. Johnsville, the certificate of which he had indorsed with a blank assignment and power of attorney to transfer, duly signed, and purporting to be for value received, and which he had delivered to G. B. & D., his stock brokers, to secure any balance of account, then about \$3,000. These brokers, without the authority or knowledge of the plaintiff, pledged these shares to the Tenth National Bank, along with other securities, to secure an advance of \$45,135; after the other securities were sold, there was left a balance of \$15,219 of the advance unpaid. Court below gave judgment for the plaintiff, and defendant appealed.]

RAPALLO, J. The pledge of the plaintiff's shares by his brokers, for a larger sum than the amount of their lien thereon, was a clear violation of their duty, and excess of their actual power. And if the effect of the transaction was merely to transfer to the appellant, through Fred. Butterfield, Jacobs & Co., the title or interest of Good-year Brothers and Durant in the shares, the judgment appealed from was right.

It must be conceded, that as a general rule, applicable to property other than negotiable securities, the vendor or pledgor can convey no greater right or title than he has. But this is a truism predicable of

<sup>1</sup> Statement abridged, arguments and part of opinion omitted.

a simple transfer from one party to another where no other element intervenes. It does not interfere with the well-established principle, that where the true owner holds out another, or allows him to appear, as the owner of, or as having full power or disposition over, the property, and innocent third parties are thus led into dealing with such apparent owner, they will be protected. Their rights in such cases do not depend upon the actual title or authority of the party with whom they deal directly, but are derived from the act of the real owner, which precludes him from disputing, as against them, the existence of the title or power which, through negligence or mistaken confidence, he caused or allowed to appear to be vested in the party making the conveyance. *Pickering v. Busk*, 15 East 38; *Gregg v. Wells*, 10 Adol. & El. 90; *Saltus v. Everett*, 20 Wend. 267, 284; *Mowrey v. Walsh*, 8 Cow. 238; *Root v. French*, 13 Wend. 570.

The true point of inquiry in this case is, whether the plaintiff did confer upon his brokers such an apparent title to, or power of disposition over, the shares in question, as will thus estop him from asserting his own title, as against parties who took *bona fide* through the brokers.

Simply intrusting the possession of a chattel to another as depositary, pledgee or other bailee, or even under a conditional executory contract of sale, is clearly insufficient to preclude the real owner from reclaiming his property, in case of an unauthorized disposition of it by the person so intrusted. *Ballard v. Burgett*, 40 N. Y. R. 314. "The mere possession of chattels, by whatever means acquired, *if there be no other evidence of property or authority to sell from the true owner*, will not enable the possessor to give a good title." Per Denio, J., in *Covill v. Hill*, 4 Denio 323.

But if the owner intrusts to another, not merely the possession of the property, but also written evidence, over his own signature, of title thereto, and of an unconditional power of disposition over it, the case is vastly different. There can be no occasion for the delivery of such documents, unless it is intended that they shall be used, either at the pleasure of the depositary, or under contingencies to arise. If the conditions upon which this apparent right of control is to be exercised are not expressed on the face of the instrument, but remain in confidence between the owner and the depositary, the case can not be distinguished in principle from that of an agent who receives secret instructions qualifying or restricting an apparently absolute power.

In the present case, the plaintiff delivered to and left with his brokers, the certificate of the shares, having indorsed thereon the form of an assignment, expressed to be made "for value received," and an irrevocable power to make all necessary transfers. The name of the transferee and attorney, and the date were left blank. This document was signed by the plaintiff, and its effect must be now considered.

It is said in some English cases, that blank assignments of shares in corporations are irregular and invalid; but that opinion is expressed in cases where the shares could only be transferred by deed under

seal, duly attested, and is placed upon the ground that a deed can not be executed in blank.

Without referring to the American doctrine on that subject, it is sufficient to say that no such formality was requisite in this case. It was only necessary to a valid transfer as between the parties, that the assignment and power should be in writing. The common practice of passing the title to stock by delivery of the certificate with blank assignment and power has been repeatedly shown and sanctioned in cases which have come before our courts. Such was established to be the common practice in the city of New York, in the case of *The New York and New Haven Railroad Company v. Schuyler*, 34 N. Y. 30, and the rights of parties claiming under such instruments were fully recognized in that case. And in the case of *Kortright v. The Commercial Bank of Buffalo*, 20 Wend. 91, and 22 Wend. 348, the same usage was established as existing in New York and other states, and it was expressly held that even in the absence of such usage a blank transfer on the back of the certificate, to which the holder has affixed his name, is a good assignment; and that a party to whom it is delivered is authorized to fill it up, by writing a transfer and power of attorney over the signature.

It has also been settled, by repeated adjudications, that as between the parties, the delivery of the certificate, with assignment and power indorsed, passes the entire title, legal and equitable, in the shares, notwithstanding that, by the terms of the charter or by-laws of the corporation, the stock is declared to be transferable only on its books; that such provisions are intended solely for the protection of the corporation, and can be waived or asserted at its pleasure, and that no effect is given to them except for the protection of the corporation; that they do not incapacitate the shareholder from parting with his interest, and that his assignment, not on the books, passes the entire legal title to the stock, subject only to such liens or claims as the corporation may have upon it, and excepting the right of voting at elections, etc. *Angell and Ames on Corporations*, 8th ed., section 354; *Bank of Utica v. Smalley*, 2 Cow. 770; *Gilbert v. Manchester Co.*, 11 Wend. 627; *Kortright v. Commercial Bank of Buffalo*, 22 Wend. 348, 362; *N. Y. and N. H. R. Co. v. Schuyler*, 34 N. Y. 30.

In the case of *Kortright v. Com. Bank*, Chancellor Walworth, in a dissenting opinion, strenuously maintained, in conformity with his previous decision in *Stebbins v. Phoenix Ins. Co.*, 3 Paige 356, that by a transfer not on the books, the transferee acquired only an equitable right to or lien on the shares; and that, having but an equitable right or lien, he took subject to all prior equities which existed in favor of any other person from whom such assignment was obtained. 22 Wend. 352, 353, 355. But his view was overruled by the majority of the court. The action was at law in assumpsit, brought by the holder of the certificate and power, for a refusal to permit him to make a transfer on the books, and the question of his legal title was necessarily involved in the case. The judgment therein must therefore be regarded as a direct adjudication that, as between the parties,



the legal title to the shares will pass by delivery of the certificate and power. See 20 Wend. 362.

This was reasserted in this court in the New Haven Railroad Case, 34 N. Y. 80, notwithstanding what was said in the Mechanics' Bank Case, 13 N. Y. 625.

By omitting to register his transfer, the holder of the certificate and power fails to obtain the right to vote, and may lose his stock by fraudulent transfer on the books of the company, by the registered holder, to a *bona fide* purchaser (34 N. Y. 80); but in this respect he is in a condition analogous to that of the holder of an unrecorded deed of land, and possesses a no less perfect title as against the assignor and others. And he would have an action against the corporation, for allowing such a transfer in violation of his rights. (34 N. Y. 80.) He also takes the risk of the collection of dividends by his assignor, or of any lien the corporation may have on the shares. But in other respects his title is complete.

The holder of such a certificate and power, possesses all the external *indicia* of title to the stock, and an apparently unlimited power of disposition over it. He does not appear to have, as is said in some of the authorities cited, concerning the assignee of a chose in action, a mere equitable interest, which is said to be notice to all persons dealing with him that they take subject to all equities, latent or otherwise, of third parties; but, apparently, the legal title and the means of transferring such title in the most effectual manner.

Such, then, being the nature and effect of the documents with which the plaintiff intrusted his brokers, what position does he occupy toward persons who, in reliance upon those documents, have in good faith advanced money to the brokers or their assigns on a pledge of the shares? When he asserts his title, and claims, as against them, that he could not be deprived of his property without his consent, can not he be truly answered that, by leaving the certificate in the hands of his brokers, accompanied by an instrument bearing his own signature, which purported to be executed for a consideration and to convey the title away from him, and to empower the bearer of it irrevocably to dispose of the stock, he in fact "substituted his trust in the honesty of his brokers for the control which the law gave him over his own property," and that the consequences of a betrayal of that trust, should fall upon him who reposed it, rather than upon innocent strangers, from whom the brokers were thereby enabled to obtain their money?

These principles in substance were applied in the case of Kortright v. The Commercial Bank. But it is sought to distinguish that case from this; and it is argued, that there the certificate was intrusted to an agent, with authority from his principal to borrow money upon it for the benefit of his principal, and that he simply exceeded his authority by borrowing more than he was authorized to borrow, and absconding with the excess. \* \* \*

The principles of agency are, however, applicable to this case. In disposing of a pledge, the pledgee acts under a power from the



pledgor. The distinction between a lien and a pledge is said to be, that a mere lien can not be enforced by sale by the act of the party, but that a pledge is a lien with a power of sale superadded. Story on Bailments, 7th ed., § 311, note 2; Wasson v. Smith, 2 B. & Ald. 439. The pledgee in selling, is bound to protect the interests of the pledgor, and, as to the surplus, represents the pledgor exclusively. Now, for what purpose was the apparent ownership and power of disposition of this stock vested in the brokers? Surely for the purpose of enabling them, effectually and summarily, to execute this power under certain conditions. If the power was absolute on its face, or if the whole legal title was by the instrument apparently vested in the pledgee, and the condition was secret, wherein does the case differ in principle from one of ordinary agency?

I am at a loss to conceive on what principle it can be claimed, that an apparent naked authority is more effectual to bind the party giving it, than an apparent ownership as well as authority.

In the case of *Jarvis v. Rogers*, 13 Mass. 105, the shares were transferable by indorsement of the certificates. The shareholder indorsed his certificates and pledged them for a debt. The debtor's friend, by his authority, and with his funds, paid the debt and took up the certificates, and the debtor allowed them to remain thus indorsed, in his hands, but not for any specific purpose. This friend afterward pledged them for his own debt to a party who advanced thereon in good faith. It was decided that the latter could hold them against the true owner.

The court after distinguishing the case from one of mere bailment, says that after the plaintiff had put his name on the back of the certificates, and allowed them to go into the market with that transferable quality about them, it did not lie in the mouth of him who offered them to the world in that shape to deny the effect of his own words and actions.

This decision was adhered to, and repeated in *Jarvis v. Rogers*, 15 Mass. 389, and recognizes substantially the same doctrine as *Kortright v. The Commercial Bank*, omitting the element of excess by an agent, of authority actually given, which is supposed to have governed that case.

*Fatman v. Loback*, 1 Duer 354, is a case precisely in point, and I see no ground upon which the conclusions of the learned court in that case can be successfully assailed. The case of *McCready v. Rumsey*, 6 Duer 574, which is cited as overruling *Fatman v. Loback*, has no such effect. The question in 6 Duer was between the assignee of the shares and the *corporation*, and it was held that the lien of the corporation on the stock for unpaid subscription was protected where the transfer was not made on the books, a position fully recognized in this opinion, and in the cases I have cited. Moreover in the case in 6 Duer, the general act under which the corporation was formed, provided that transferees of shares should take subject to the liabilities of prior shareholders.

In the cases of *Ex parte Swan*, 7 C. B. N. S. 400; *Swan v. The*

North British Australasian Co., 7 Hurl. & Nor. 603, and Swan v. The North British Australasian Co., 2 Hurl. & Coltman 175, some of these questions receive a most elaborate discussion, and there was a strong array of judicial opinions sustaining the validity of transfers of stock, unauthorized in point of fact on the ground that by mere negligence, and unintentionally, the true owner had enabled another to deliver an apparently valid title to the stock, and thus deceive third parties.

In that case, the plaintiff had intrusted to a broker ten deeds of transfer, executed in blank, for the purpose of transferring certain shares. The broker used only eight of them for the purpose intended, and feloniously filled up and used the others as transfers of other shares, belonging to the same party, forged the name of a subscribing witness, and stole the certificates of the shares from the plaintiff's box, of which the plaintiff kept the key. He then sold the shares to *bona fide* purchasers. He was convicted of the larceny.

In a contest by the owner to get back the shares, the common bench was, after two arguments, equally divided upon the question whether the owner was not estopped from reclaiming the shares, by reason of his negligence in intrusting the blank transfers to the broker, though they were intended for other shares. The case was taken to the court of exchequer, and that court was equally divided upon the same question. It was then taken to the exchequer chamber, where it was finally disposed of, principally on the ground, that to estop the owner, his negligence must be the proximate cause of the deceit. That here it was too remote, as the blank deeds of transfer were intended for other shares, and the broker had to commit forgery to make them available, and a separate felony to obtain possession of the certificates.

In the case at bar none of these difficulties exist. The assignment and power were intended for these identical shares; they, as well as the certificate, were voluntarily intrusted by the plaintiff to the brokers, and the latter were thus invested with the apparent ownership and right of disposal, not merely by the negligence of the true owner, but by his voluntary act, and for the very purpose of attesting to the world their title and power, in case the contingency should arise, in which, according to the understanding between them and the plaintiff, they would be justified in resorting to the stock for their own indemnity. \* \* \*

My conclusion is that the Tenth National Bank must, on the facts found, be deemed to have advanced *bona fide* on the credit of the shares, and of the assignment and power executed by the plaintiff, and is entitled to hold the stock for the full amount so advanced, and remaining unpaid, after exhausting the other securities received for the same advance. \* \* \*

The judgment of the general term, and that entered on the report of the referee, should be modified, so as to allow the plaintiff to redeem, on payment of the balance due to the Tenth National Bank, on its advance of June 19, 1868, and the costs of the action.

All concur except Allen and Folger, JJ., not voting.

*Judgment modified.*

*Note.* See, 1899, Brittan v. Oakland Bank, 124 Cal. 282; 1900, Dueber Watch Case Mfg. Co. v. Daugherty, 62 Ohio St. 589, 57 N. E. Rep. 455; 1900, Westinghouse v. German Natl. Bk., 196 Pa. St. 249, 46 Atl. Rep. 380.

Sec. 561. Same. (4) 'Fraudulent transfer by agent.

THE MERCHANTS' BANK OF CANADA, RESPONDENT, v. LIVINGSTON,  
APPELLANT.<sup>1</sup>

1878. IN THE COURT OF APPEALS OF NEW YORK. 74 N. Y. Rep.  
223-228.

EARL, J. This is an action to foreclose a pledge of certain shares of stock in the Adams Express Company.

Some time prior to January, 1875, the defendant, Livingston, being the owner of 100 shares of such stock, delivered the certificate thereof to the defendant, Barrett, to secure a loan from him of about \$3,000. In January, 1875, Barrett took the certificate of stock to one Watson, the resident manager of the plaintiff, in the city of New York, and told him he wanted to get a loan of \$8,000 from the plaintiff, upon the stock represented by the certificate, for one of his clients, who did not wish to sell the stock, but would rather hold it. The certificate was then in the name of Livingston, but there was no indorsement upon it, nor power of attorney attached to it. Watson informed Barrett that if he would bring a proper power of attorney attached to the certificate, he would make the loan. Thereafter Barrett, by representing that he ought to have the instrument to secure his loan of the \$3,000, procured Livingston to sign a printed blank transfer and irrevocable power of attorney to make a transfer of such certificate. Barrett then again took the certificate of stock and the power of attorney signed by Livingston, filled up, except the name of the transferee and attorney, to Watson, and delivered them to him, and received a check for \$8,000, payable to his order, on which he drew the money. He subsequently, in the same way, borrowed, upon the security of the stock, as he represented for his client, \$1,000 more. He afterwards absconded, and never paid any of the money to Livingston; and he was not authorized by Livingston to borrow it or pledge the stock. It has thus far been decided in this case that the plaintiff is entitled to the stock for the security of the loan made by it, and the decisions have been based upon the authority of *McNeil v. Bank*,<sup>2</sup> and other similar cases.

It was held in those cases that a blank transfer of a certificate of stock, with irrevocable power of attorney to transfer, signed by the

<sup>1</sup> Arguments omitted.

<sup>2</sup> 46 N. Y. 325, *supra*, p. 1674.

person who appears by the certificate to be the owner, like that used in this case, confers upon the holder of this certificate and power of attorney the apparently legal and equitable title to the stock, and that a *bona fide* purchaser of such stock from such holder can hold the stock against the real owner, who is estopped from asserting his title. The principles upon which those cases rest are fully set forth in the case of *McNeil v. Bank*, and need no further elucidation here. In such cases the apparent owner, in his dealings with persons, relying in good faith upon the appearances, is the real owner, and may sell or pledge the stock and deal with it in all respects just as the real owner could. But in that case and the other similar cases the holder claimed to be just what the appearance indicated—the real owner—and to deal with the stock as such.

But this case is distinguishable from those. Barrett did not claim to be the owner of the stock. He represented that it belonged to his client, and by that must have been understood to mean Livingston, whose name appeared in the certificate as the owner of the stock; and he represented that he wanted a loan for his client. He had no authority, in fact, to make the loan for him, and he had nothing to show that he had such authority. He was clothed with no apparent authority to make such loan. The power of attorney gave no such apparent authority. There was nothing in that showing any connection with a loan, and that added nothing to his apparent authority. All the plaintiff had then, when it made the loan, was the naked assertion of Barrett that he was acting for Livingston; and upon that assertion it relied at its own risk. It could not hold Livingston for the loan; and this being so, what right had it to take and hold Livingston's stock? Knowing that the stock did not belong to Barrett, it could not take it as security for a loan to him. It, at most, had information that Barrett could only pledge the stock for a loan to Livingston; and if he was not authorized to make the loan, he was not authorized to make the pledge. At the very most, the appearances indicated that Barrett was authorized to pledge the stock for an authorized loan, but not for a loan which he was not authorized to make.

In such a case, the doctrine of estoppel does not apply. Livingston did not hold Barrett out as authorized to borrow money for him; and hence he is not estopped from denying such authority. He did not hold him out as authorized to pledge his stock for such a loan; and hence he is not estopped from disputing the pledge.

If Barrett had gone to the plaintiff with the certificate and power of attorney, claiming to own the stock, he could have pledged it for a loan to himself or any other person. If he had been authorized by Livingston to borrow the money, he could probably have pledged the stock in his possession to secure it. And he could have taken the certificate and power of attorney and gone into the market, claiming to act as the agent of the plaintiff, and have sold the stock and given a good title. The possession of the certificate and full power of attorney would have given him the apparent authority to sell. But a

power to sell is not a power to pledge to secure money borrowed. An agent to sell is not agent to pledge. (Story on Agency, § 78; Henry v. Marvin, 3 E. D. Smith, 71; Banito v. Mosquera, 2 Bosw. 401.)

It may be that Barrett transferred to the plaintiff all the interest he had in the stock as pledgee of Livingston; and whatever that was may be protected upon another trial.

*Judgment reversed.*

Sec. 562. Same. (5) Fraudulent transfer in breach of trust.

WINTER v. MONTGOMERY GAS LIGHT COMPANY.<sup>1</sup>

1889. IN THE SUPREME COURT OF ALABAMA. 89 Ala. Rep. 544-551.

[Bill of interpleader by the bank to compel the administrator of the estate of D. C. Schanck, and Mrs. Mary E. Winter to contest between themselves the ownership of certain shares of stock, with the accrued dividends claimed by both.]

CLOPTON, J. \* \* \* The uncontroverted facts are: On March 30, 1871, there stood on the books of the Montgomery Gas Light Company, thirty shares of its capital stock in the name of "J. S. Winter, trustee, for Mary E. Winter." On that day J. S. Winter, trustee, assigned the thirty shares to J. Gindrat Winter, which transfer was registered on the books of the company. On August 21, 1871, certificates for the five shares in controversy, being part of the thirty shares, were issued by the company to J. Gindrat Winter, who, on the 25th day of the same month, delivered them to J. S. Winter, indorsing on each a power of attorney, authorizing him to transfer, set over, and assign on the books of the company the shares to such person or persons, and for such consideration, as he may elect, with full power to appoint one or more persons with like powers and authority to make and effect the transfer of the shares. On August 26, 1871, J. S. Winter, by instrument in writing, assigned and transferred the certificates of shares, with all dividends, to D. S. Schanck to secure the payment of three notes, amounting in the aggregate to \$500, his individual debt, with irrevocable power of attorney to Schanck to surrender the stock and have the same issued to him in his own name. It appears from the pleadings and evidence that the stock was the statutory separate estate of Mrs. Winter. It is insisted that the transfer to J. Gindrat Winter is void, for the reason that under the statutes then in force no valid sale or conveyance of the separate estate of a married woman could be made other than by an instrument in writing, executed by her husband and herself jointly, attested by two witnesses, or acknowledged as provided by law. It will be admitted that J. S. Winter, holding the stock as trustee for his wife, and as her statutory separate estate, had no right or authority to sell and transfer

<sup>1</sup> Statement abridged.

or to pledge it for his individual debt; also that J. Gindrat Winter having notice of the trust, both of them are responsible to the *cestui que trust* for the unauthorized use and disposition of the stock. The insistence of counsel would be sustained if the question involved only the validity of the transfer to J. Gindrat Winter or his transferee with notice. But the question presented by the record reaches beyond this, and is, when a certificate of the stock is accompanied by a power of attorney indorsed thereon, by the person in whose name it is issued, authorizing the attorney to transfer it to any person, and for such consideration as he may elect, will the title of a purchaser for value, without notice of any intervening equity, be protected? The general rule is that when the legal title and apparent unlimited power of disposition is vested in a person, the rights of a purchaser from him, for a valuable consideration, without notice of a secret trust upon which the property is held, are unaffected. The purchaser, in such case, acquires an equity equal in dignity to the outstanding equity of which he has no notice. This principle is applicable to the sale and transfer of certificates of stock. It has accordingly been held that a power of attorney on a certificate of stock, authorizing its transfer to any person, renders the stock transferable by delivery, and if the holder of such certificate is shown to be a purchaser for value, without notice of an outstanding equity from the person to whom it was issued, or his transferee, his title as such owner can not be impeached. This principle, so far as we have discovered, is uniformly sustained by the authorities. \* \* \*

The rule is that as between two equities merely the prior equity will prevail; hence in order to give the purchaser precedence, unless under exceptional circumstances, the legal estate must be annexed to his equity. It is contended that the purchaser of a certificate of stock obtains the legal title only by a registry of the transfer on the corporate books, and that the transfer to Schanck not having been registered, the equity of Mrs. Winter is superior. By an examination of the cases in which it has been expressed that a transfer on the books of the corporation is essential to pass the legal title, it will be seen that the expression was used in reference to the construction and purpose of the statute, making the stock of the corporation transferable on the books, and to protection against creditors and subsequent purchasers. In *Union Nat'l Bank v. Hartwell*,<sup>1</sup> we said that to this end, and for this purpose, the transfer must be made in the mode prescribed by the statute; and while a transfer on the books is essential to pass the legal title, and operate as notice, a purchaser of the stock, though no registry is made on the books, may acquire such right thereto as a court of equity will enforce and compel its transfer on the books. And in *Campbell v. Iron Co.*,<sup>2</sup> speaking of the transfer of a certificate of stock without registration on the books, it is said: "If in proper form, and otherwise unobjectionable, such a conveyance is good and valid between the parties, although it may be void as against *bona fide* creditors, or subsequent purchasers without notice, and although

<sup>1</sup>84 Ala. 379.      <sup>2</sup>83 Ala. 351.



as against the corporation itself it may convey an equitable title, conferring no right to vote, draw dividends, or other like incidents of ownership." *Berney Nat'l Bank v. Pinckard*, 87 Ala. 577. What title passes, as between the parties, is a different question. The registry on the books of the company of J. Gindrat Winter, as the owner, and the issue of new certificates in his name, vested the legal title in him, and clothed him with all the *indicia* of ownership and the apparent right of disposition. As between him and Schanck, his transfer passed to the latter the title he possessed, and armed the latter with power to compel a transfer on the corporate books, and his representative demanded, October 5, 1886, the transfer to be registered. Whether, in such case, the title of Schanck will be upheld against intervening equities arose and was expressly decided in *Dodds v. Hills*;<sup>1</sup> in which case Smith, at the time he took the transfer, had no notice that Hills held the stock in trust, but received notice before he sent it for registration. It is said: "Although it is true that, as between him and the company, Smith did not become the owner until after registration, nothing but his own act was necessary to make him complete master of the shares. His position was like that of a person to whom an estate is conveyed, to become legally vested on the performance of some condition, such as the making of a demand, or the like; and in such a case notice of a trust would not prevent the subsequent performance or effect of this condition." And in *Cook Stock and Stockholders*, § 325, the author, after alluding to the rule in England, remarks: "In this country a different rule prevails, and it is accepted and assumed as elementary that a *bona fide* purchaser for value, of stock belonging to a trust estate, and sold in breach of trust, is nevertheless protected in the purchase, although he has not registered the transfer on the corporate books." The case of *East Birmingham Land Co. v. Dennis*<sup>2</sup> does not militate against this view. In that case, on the principle that a certificate of stock, indorsed in blank by the person to whom it was issued, is not a negotiable instrument, which may be regarded as well settled, it was held that, such certificate having been lost or stolen from the owner without fault on his part, his right to it is superior to that of any other person who may acquire it by purchase for value from any other holder. It will be observed that the finder or thief had no apparent right or claim; no color of title. The blank in the power of attorney was not filled in. The transferrer was not possessed of the legal title, or any *indicia* of ownership, or the apparent power of disposition. Schanck derived title to himself directly from the last registered stockholder. The cases are not parallel. By J. S. Winter's transfer to J. Gindrat Winter, causing it to be registered, and by the issue of new certificates in his name by the company, the transferrer to Schanck was vested with the legal title, regular on its face, without any indications to awaken suspicion. He acquired the title which his transferrer had, but no better, except that it was discharged from the trust,—a legal title sufficient to his protection against

<sup>1</sup> 2 Hem. & Mill. 424.<sup>2</sup> 85 Ala. 565.

prior latent equities. In *Mills v. Townsend*<sup>1</sup> it is said that “while a transfer of shares by an assignment of the certificates can be effective only between the parties to the assignment, it has been held, in accordance with the usages of trade, that the indorsement of the certificates invests the assignee with the legal title to the interest so assigned as against all persons except the corporation.” It was ruled that a *bona fide* purchaser, through mesne conveyances, starting from a trustee who sells the stock in breach of a trust, is protected. While certificates of stock are not negotiable instruments, when indorsed in blank, they are, nevertheless, intended to pass from hand to hand by delivery. The purchaser looks to the genuineness of the certificates, and, the *indicia* of ownership appearing on their face, he is without means to ascertain the rights of his vendor. If the purchaser were required to look beyond the last registry on the books of the corporation to ascertain whether there are any equities, or whether the stock was held in trust, facility in disposing of them would be greatly obstructed, if not destroyed. Hence, a purchaser for value from the party who is the last-registered stockholder, and to whom new certificates have been issued without notice, is not affected by the rights of holders back of the registry. *Cook Stock and Stockholders*, §§ 369, 443. There is no pretense that Schanck had any notice of Mrs. Winter’s equity, and in the instrument assigning the certificates to him, J. S. Winter covenants and agrees that he is the lawful owner and holder of the stock, and has just right and authority to sell and dispose of the same. The company is estopped to deny Schanck’s right and title, and to his equity a legal title was annexed sufficient to give him precedence over the equity of Mrs. Winter, of which he had no notice, and which was back of the registry to J. Gindrat Winter. *Mandlebaum v. North Am. Min. Co.*, 4 Mich. 465.

*Affirmed.*

**Sec. 563. Same. (6) Fraudulent transfer in breach of a trust—**  
Liability of the corporation.

LORING, TRUSTEE, v. SALISBURY MILLS.<sup>2</sup>

1878. IN THE SUPREME JUDICIAL COURT OF MASSACHUSETTS. 125  
Mass. Rep. 138-153.

[Tort brought by Loring, successor of one Rogers, as trustee for Mrs. Mountford, for an illegal issuing of certificates of stock by the corporation.]

GRAY, C. J. \* \* \* When the holder of a certificate of shares in a corporation is the absolute owner, his assignment and delivery thereof will pass the title to the assignee; and the latter, upon surrendering the former certificate, may obtain a new one in his own name. *Stone v. Hackett*, 12 Gray 227, Gen. Sts., ch. 60, §§ 9, 10, 13; St. 1870, ch. 224, §§ 22, 23, 26. If the holder appears, upon the face of the old certificate, to be the absolute owner, and the corporation has no notice that

<sup>1</sup> 109 Mass. 115.      <sup>2</sup> Statement abridged, and part of opinion omitted.

the fact is otherwise, it may safely issue a new certificate to the assignee, which, if taken in good faith and for a valuable consideration, will vest a perfect title in him. *Salisbury Mills v. Townsend*, 109 Mass. 115; *Pratt v. Taunton Copper Co.*, 123 Mass. 110. But, for the protection of the rights of the lawful owner of the shares, the corporation is bound to use reasonable care in the issue of certificates; if, by the form of the certificate or otherwise, the corporation has notice that the present holder is not the absolute owner, but holds the shares by such a title that he may not have authority to transfer them, the corporation is not obliged, without evidence of such authority, to issue a certificate to his assignee; and if, without making any inquiry, it does issue a new certificate, and the rightful owner is injured by its negligent and wrongful act, the corporation is liable to him without proof of fraud or collusion. All the authorities affirm such liability where the corporation has notice that the present holder is a trustee and of the name of his *cestui que trust*, and issues the new certificate without making any inquiry whether his trust authorizes him to make a transfer. *Lowry v. Commercial and Farmers' Bank*, Taney 310; *Bayard v. Farmers' and Mechanics' Bank*, 52 Pa. St. 232; *Atkinson v. Atkinson*, 8 Allen 15; *Shaw v. Spencer*, 100 Mass. 382; *Fisher v. Brown*, 104 Mass. 259; *Duncan v. Jaudon*, 15 Wall. 165.

The cases of transfer of stock by the Bank of England,<sup>1</sup> cited by the learned counsel for the defendant, depended, as was pointed out by Chief Justice Taney, in *Lowry v. Commercial and Farmers' Bank*, upon the peculiar provisions of acts of parliament. Taney 335. The case of *Duncan v. Luntley*, 2 Mac. & Gord. 30, s. c. 2 Hall & Twells 78, was decided upon the ground that the bill alleged that the act of the officers was unauthorized by the company. And the latest English case upon the subject goes quite as far as any of the American authorities in protecting equitable rights in shares held in trust. *Shropshire Union Railways v. The Queen*, L. R. 7 H. L. 496.

Upon the evidence, there can be no doubt that the defendant corporation had notice that all the shares in question were held by Rogers in trust for Mrs. Mountford. At the organization of the corporation, Rogers subscribed for one hundred and fifty shares, and took out a certificate in this form: "Be it known that George H. Rogers, trustee for Mrs. E. B. Mountford, is proprietor of one hundred and fifty shares in the capital stock of the Salisbury Mills, which shares are transferable by an instrument in writing, to be recorded by the clerk of the company; and when such transfer shall have been recorded, and this certificate surrendered to the treasurer of the company, a new certificate or certificates shall be issued." In 1858 Rogers subscribed successively for eighty and for twenty more shares, and took the certificates therefor in the name of "George H. Rogers, trustee," without naming his *cestui que trust*. But in 1859, upon the corporation increasing its capital stock by one-half, Rogers, then holding, as we have

<sup>1</sup> *Hartga v. Bank of England*, 3 Ves. 55; *Bank of England v. Parsons*, 5 Ves. 665, 669; *Pearson v. Bank of England*, 2 Cox Ch. 175; *Davis v. Bank of England*, 2 Bing. 393, 407.

seen, certificates for two hundred and fifty shares, namely, one hundred and fifty as trustee for Mrs. Mountford, and the additional one hundred as trustee simply, took the proportion of the new stock, to which he was entitled on the whole two hundred and fifty shares, in a single certificate for one hundred and twenty-five shares, as "trustee for Mrs. E. B. Mountford," thereby clearly signifying that he held all the old shares as well as the new, being three hundred and seventy-five shares in all, in trust for her. In 1862, Rogers sold the twenty shares subscribed for in 1858, and accounted to Mrs. Mountford for the proceeds thereof, and the remaining three hundred and fifty-five shares continued to be held by him upon the same trust. In 1863, under a vote of the corporation further increasing its capital stock by one-third, and allowing each stockholder of record to take his *pro rata* proportion, Rogers took a certificate for one hundred and eighteen shares (being one-third of three hundred and fifty-five, excluding fractions) in the name of "George H. Rogers, trustee." He then held four hundred and seventy-three shares, the whole of which and of the dividends accruing thereon were credited on the books of the corporation in one account to "George H. Rogers, trustee," and the dividends, as they were paid, were receipted for by him in one receipt upon those books.

The corporation, thus having distinct notice that Rogers held all these shares as trustee for Mrs. Mountford, was bound, upon the principles already stated, when he afterwards undertook to transfer the shares, to inquire whether the terms of the trust authorized him so to do.

By the indenture of trust, the trustee was authorized to sell, invest and reinvest the trust property, only upon first obtaining the written approbation of Mrs. Mountford, the *cestui que trust*, if at the time within the United States; and it appears that she was within the United States at the times of all the sales and transfers complained of.

The invalidity of these sales and transfers is not affected by Mrs. Mountford's knowledge of and assent to the sale of the twenty shares by Rogers in 1862, nor by her written assent to his sale of other property, nor by her request (which is not shown to have been acted on by him or known to the defendant) to pledge some of her shares in the defendant corporation for her benefit. The letters of her husband, not proved to have been authorized by her, can not affect her rights. As Rogers, by the terms of the trust, had no authority to pay the income to Mrs. Mountford, except as it accrued and not by way of anticipation, he had no right to sell the trust property to reimburse himself for advances to her, and her settlement with his executor of a claim for such advances is no bar to this suit.

The transfers complained of having been made by the defendant corporation without due inquiry into the authority of Rogers to make them, and being invalid against the *cestui que trust*, and the new trustee appointed in the place of Rogers not being able, as we have already held, for technical reasons, to maintain an action at law against the corporation, he is clearly entitled to maintain this bill in equity. *Ashton v. Atlantic Bank*, 3 Allen 217.

Rogers and the corporation both contributed to the wrong done, and the proof of the claim against the estate of Rogers, one of the wrong-doers, was no affirmance of the validity of his acts, and is no bar to a suit against the corporation, the other wrong-doer, except to the extent of the satisfaction received by the dividends out of the estate of Rogers. *Elliott v. Hayden*, 104 Mass. 180.

The result is, that the plaintiff is entitled to the relief prayed for, and the form of the decree must be settled before a single judge.

*Decree for the plaintiff.*

*Note.* See, 1872, *Sprague v. Cocheco Mfg. Co.*, 10 Blatch. 173; 1890, *Marbury v. Ehlen*, 72 Md. 208, 20 Am. St. Rep. 467; 1890, *Colonial Bank v. Cady*, L. R. 15 App. Cas. 267; 1902, *Wooten v. Wilmington & Weldon R. R. Co.*, 128 N. C. 119, 56 L. R. A. 615.

As to the general liability of the corporation for making or recognizing improper transfers, see, *infra*, § 568.

## Sec. 564. Same. (7) Gifts of shares.

### COMMONWEALTH v. CROMPTON.<sup>1</sup>

1890. IN THE SUPREME COURT OF PENNSYLVANIA. 137 Pa. St. Rep. 138-148.

[Proceedings to escheat, as the property of one McNaughton, deceased, certain bonds and railroad stocks in the possession of appellee, Mrs. Crompton, administratrix of his estate, but which she claimed to have been given to her. Testimony offered showed that at the death of McNaughton, a certain box containing the bonds and stocks was in the custody of Mrs. Crompton; that it had been given to her by McNaughton in the June before his death; that he said at the time, "Take it, it will be of some use to you after I die;" she took it, went out, and when she came back, he gave it to her again, and told her to put it away, it would be of some use to her; "it will be of some use to you when I am gone." She put it away, and it was taken from her bureau drawer the Thanksgiving day after McNaughton's death.]

MR. JUSTICE MCCOLLUM. \* \* \* A gift needs no consideration to support it, yet in the present case there was a valuable one acknowledged by the donor, and impelling him to the action which is the subject of this controversy. For twenty-one years he lived in the family of the donee as a boarder, and had his washing and mending done there, and for these he promised to pay her. He was in poor health the last four years of his life, and required and received from her and her children considerate care and attention. He often manifested grateful appreciation of these services, and expressed a purpose to make compensation for them. In execution of this purpose, he delivered to her the box containing the government bond and the certificates of railroad stock. It is apparent from the evidence that he intended to make an absolute gift of these securities to her, and that he supposed the delivery, and the words accompanying it, invested

<sup>1</sup> Statement abridged, Arguments and part of opinion omitted.



her with the exclusive control and ownership of them. There remains for consideration the question whether the failure to make a formal written transfer of the securities to the donee, will defeat the purpose of the donor and give them to the commonwealth as an escheat.

It is now settled that a valid gift of non-negotiable securities may be made by delivery of them to the donee without assignment or indorsement in writing. This principle has been applied to notes, bonds, stock and deposit certificates, and life insurance policies. In Pennsylvania, *Wells v. Tucker*, 3 Binn. 366; *Licey v. Licey*, 7 Pa. 251, and *Madeira's App.*, 17 W. N. 202, are illustrations of and rest upon it, and it has distinct recognition and approval in other deliverances of this court. In *Walsh's App.*, 122 Pa. 177, we refused to extend it to a depositor's bank-book, but acknowledged "that, in the case of notes and other instruments payable to order, a delivery accompanied by words importing a present absolute gift would invest the donee with the ownership of the fund." The bank-book was regarded as on the same footing as a book of original entries, and the mere delivery of it to the donee as insufficient to pass any title to the accounts appearing upon it. But "a certificate of deposit is a subsisting chose in action, and represents the fund it describes, as in case of notes, bonds, and other securities, so that delivery of it as a gift constitutes an equitable assignment of the money for which it calls." *Basket v. Hassell*, 107 U. S. 602. In the case last cited, Mr. Justice Matthews, after an exhaustive examination of the authorities, said: "The point which is made clear by this review of the decisions on the subject, as to the nature and effect of a delivery of a chose in action, is, as we think, that the instrument or document must be the evidence of a subsisting obligation, and be delivered to the donee so as to vest him with an equitable title to the fund it represents and to divest the donor of all present control and dominion over it, absolutely and irrevocably, in case of a gift *inter vivos*, but upon the recognized conditions subsequent, in case of a gift *mortis causa*."

The shares of stock are choses in action, and the certificates evidence of the title to them: *Slaymaker v. Bank*, 10 Pa. 373. Why may not a delivery of the certificates, coupled with words of absolute and present gift, invest the donee with an equitable title to the stock, which the donor or a volunteer can not successfully assail? A stockholder may clothe another with the complete equitable title to his stock without compliance with the forms printed by the corporation: *United States v. Vaughan*, 3 Binn. 394; *Commonwealth v. Watmough*, 6 Wh. 117; *Building Assn. v. Sendmeyer*, 50 Pa. 67; *Finney's App.*, 59 Pa. 398; *Water-Pipe Co. v. Kitchenman*, 108 Pa. 630.

As the gift in question was supported by a valuable consideration, and the instruments which represented the ownership of the donor in the subject-matter of the gift were delivered to the donee, we think she has a title to the securities which can not be destroyed in a proceeding by the commonwealth to escheat them.

*Judgment affirmed.*

*Note.* See next case, and, 1891, *Matthews v. Hoagland*, 48 N. J. Eq. 455; 1899, *Coffey v. Coffey*, 179 Ill. 283.



## Sec. 565. Same.

PENNINGTON, ADM<sup>R</sup> OF PATTERSON, v. GITTING'S EXECUTOR.<sup>1</sup>1830. IN THE COURT OF APPEALS OF MARYLAND. 2 Gill & J.  
Rep. 208-219.

BUCHANAN, C. J. The bill was filed to compel the defendant, the executor of James Gittings, to transfer to the original complainant, Ann Patterson, daughter of the testator, seventy-five shares of stock of the Commercial and Farmers' Bank of Baltimore; a certificate of which, it alleges, was given and delivered to her by the testator, who, it is stated, indorsed his name on the back of the certificate in her presence, and at the same time informed her that he gave her the stock.

The answer admits the name of the testator, indorsed upon the certificate to be in his handwriting, but denies that he gave or intended to give the certificate of stock to Ann Patterson, as alleged, and puts the complainant on proof of the allegation, and denies also the delivery of the certificate as stated. \* \* \*

The alleged gift seems to have been intended as a *donatio inter vivos*; but whether a *donatio inter vivos* or *donatio mortis causa* makes no difference. Such a gift can not be by mere parol. The rule of law in either case is, that a *delivery* of the *thing* intended to be given, is essential to the perfection of the gift. This is admitted; indeed, it can not be denied. As to donations *inter vivos*, it has never been doubted that delivery of the thing intended to be given is indispensable; and the same principle is now equally well settled in relation to donations *mortis causa*. The delivery must be according to the manner in which the particular thing is susceptible of being delivered; and that which is not capable of being delivered is not the subject of a donation. There must be a parting by the donor with the legal power and dominion over it. If he retains the dominion, if there remains to him a *locus penitentiae* (which must be the case, when he retains the possession, and what is done is merely by parol), there can not be a perfect and legal donation, and that which is not a good and valid gift in law can not be made good in equity.

Proceeding upon this principle, the relief sought in *Mary Tate v. Hilbert*, and *Jane Tate v. Hilbert*, 2 Vesey Jr. 112, was refused where a man, a short time before his death, gave one a check on his banker, which was not presented before his death, and to the other a promissory note, both of them being his relations. They were strong cases, particularly that of the check, which, if it had been presented before the death of the deceased, would have been paid, the *banker* having sufficient funds in his hands.

But the money, the thing that was intended to be given, not having been delivered, they were not good and available donations in law; the promissory note and the check being only evidences of contract,

<sup>1</sup> Part of opinion omitted.

they did not transfer the possession of the money, nor invest the persons to whom they were respectively given with the legal dominion over it, which continued in the deceased until his death, when the property vested in the executors. A promissory note delivered as a donation, is not a vested gift of the money, but only a promise or engagement to give; and imposes no stronger obligations, nor affords a better ground of action, than a promise to deliver any chattel as a gift. Such intended donations can not be enforced on the consideration of blood, which has been insisted on in this case, and was probably a leading motive with the defendant's testator in the cases referred to, in *2 Vesey Jr. 112*, Mary Tate and Jane Tate being stated to have been his relations.

The consideration of natural love and affection is sufficient in a deed; but a mere executory contract, that requires a consideration, as a promissory note, can not be supported on the consideration of blood, or natural love and affection; there must be something more—a valuable consideration—or it is not good and can not be enforced at law, but may be broken at the will of the party. And being void at law for want of a sufficient consideration, chancery can not sustain and enforce it. The cases of *Mary Tate and Jane Tate v. Hilbert*, have been mentioned as striking cases, in which the lord chancellor manifested a strong desire, more than once expressed, to grant the relief prayed; a desire not foreign from us, so far as sitting here we are permitted to entertain it, but we are, as he then was, restrained by the settled and stubborn rules of law. The case of *Ward v. Turner, 2 Vesey Sr. 431*, is just this case. It was a bill to compel a transfer of South Sea annuities, the receipt for which had been delivered to the complainant's testator by one Flog, saying, "I give you, Mosely, these papers, which are receipts for South Sea annuities, and will serve you after I am dead." It was argued for the complainant that the delivery of these receipts, with the strong words of gift accompanying it, was as much as could be done towards giving the annuities, except a mere transfer in the books. But it was held that the annuities being the thing intended to be given, a delivery of the annuities was indispensably necessary to make it a good donation; that the delivery of the receipts was not sufficient, and that such a donation could not be made without a transfer, or something equivalent, that being the only mode in which stock or annuities are susceptible of being delivered.

It is supposed that this case differs from that, because, as is alleged, that James Gittings, at the time of delivering the certificate of stock to his daughter, indorsed his name upon the back of it (which does not appear to have been done by Flog, when he delivered the receipts for the annuities), which, it is contended, gave her authority to write over it a full assignment or a power of attorney, which would enable her to go to the bank and cause a transfer of the stock to be made to her on the books. But it is not perceived that this makes any difference, nor is it necessary to inquire whether that indorsement gave any such authority; if it did, it never was executed. It ap-

appears upon the face of the certificate itself that the stock was transferable at the bank only, and it is admitted that the indorsement, whether in blank or in full, did not and could not operate to transfer the stock; and it was the stock and not the certificate that was the subject of the intended gift, it matters not whether the indorsement was in full or in blank; for, as in the case of the check on the banker, which not being presented and paid in the lifetime of the maker, the intended donation of the money was defeated for want of delivery, notwithstanding the holder of the check might, by presenting it in the lifetime of the maker, have obtained the money and thus perfected the gift; so here, even if by the indorsement of the certificate, whether filled up or remaining in blank, Mrs. Patterson might have gone to the bank in the lifetime of her father and caused a transfer of the stock to herself on the books of the bank, the only way in which the stock, the thing that was intended to be given, could be delivered, and thus have perfected the donation; yet, not having done so, it was not a valid gift of the stock, either in law or equity, for want of delivery. It was not a valid gift in law, otherwise there would have been no necessity for going into chancery to perfect it. And being void in law, chancery can not interpose to make it good or enforce it. If Mr. Gittings was alive, it could not be seriously contended that he could be compelled to transfer the stock in the absence of any consideration; and the same principle applies to his executor. His death does not make that good which was bad before.

*Decree affirmed, with costs.*

*Note.* See preceding case. Compare 162 N. Y. 163, 48 L. R. A. 107.

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**Sec. 566. Same. (f) Effect of transfer upon liability of transferer and transferee; general rule.<sup>1</sup>**

**VISALIA & TULARE RAILROAD COMPANY, RESPONDENT, v. HYDE,  
APPELLANT.<sup>2</sup>**

1895. IN THE SUPREME COURT OF CALIFORNIA. 110 Cal. Rep.  
632-637, 52 Am. St. Rep. 136.

HARRISON, J. The plaintiff is a corporation under the laws of this state, for the purpose of constructing and operating a railroad between the city of Visalia and the town of Tulare, and was incorporated November 1, 1887, with a capital stock of one hundred thousand dollars, divided into one thousand shares of one hundred dollars each, all of which was subscribed for, and upon each share of which stock there had been paid into the corporation the sum of fifty dollars. On March 28, 1894, the directors of the corporation levied an assessment of ten dollars upon each share of the capital stock, and

<sup>1</sup> See, *infra*, creditors and shareholders, p. 1900 *et seq.*

<sup>2</sup> Arguments omitted.

in the order levying the assessment fixed a day on which the stock would be delinquent, and also a day for the sale of the delinquent stock. After the day specified for declaring the stock delinquent, and before the sale, the board of directors, by an order in that behalf, elected to waive and abandon further proceedings for the collection of the assessment by a sale of the stock, and to proceed by action to recover the amount that should be delinquent. November 29, 1890, the defendant became the owner of one hundred shares of the capital stock which had been originally subscribed for by Thomas Creighton, and on that day a certificate for said one hundred shares of stock was issued to and received by him, and he was then registered on the books of the plaintiff as the owner thereof, and has since remained registered as such stockholder. The present action is brought to recover from him the amount of the assessment, by virtue of the provisions of section 349 of the civil code. The answer to the complaint does not question the regularity of the steps taken in levying the assessment, or in the election of the plaintiff to proceed by action to collect the same, or that the plaintiff was indebted in an amount greater than the amount of the assessment; but sets up as special defenses that, at the time the plaintiff incurred the liability for which he alleges the assessment was levied, he was not a stockholder; that prior to the commencement of the action he had sold, indorsed, and delivered the shares of stock to another person; and that at the time of levying the assessment the plaintiff had sufficient property with which to meet all of its obligations, without levying an assessment therefor. The plaintiff had judgment and the defendant has appealed.

1. By purchasing the stock from Creighton, and causing a transfer thereof to himself to be entered upon the books of the plaintiff, the defendant was substituted for Creighton as a stockholder of the corporation, and thereafter held the shares on the same conditions, and subject to the same obligations, as did Creighton prior to the transfer. (Morawetz on Corporations, section 159; Cook on Stock and Stockholders, section 256; Hall v. United States Ins. Co., 5 Gill 484; Hartford, etc., R. Co. v. Boorman, 12 Conn. 530; Upton v. Hansbrough, 3 Biss. 417; Merrimac Min. Co. v. Bagley, 14 Mich. 501.) In the case last cited the court say: "The very essence of a corporation consists in its corporate succession, which, in stock companies, is kept up by the substitution of one owner for another in the proprietorship of shares. If the original stockholders stand under different relations to the company from their assigns, the corporation itself loses some of its attributes by the substitution, or else becomes introduced into more complicated relations. It seems to be an unavoidable conclusion that every liability which attaches to a stockholder, as such, is inseparable from the ownership of the stock." And in Hartford, etc., R. Co. v. Boorman, *supra*, it is said: "The reasons for subjecting the original subscribers to personal liability apply with equal force to those who become stockholders by purchase. The relation of stockholder and company exists. A privity between them is created."

The defendant did not divest himself of this liability by an assignment of the certificate to another subsequent to the levy of the assessment, especially as his assignee did not procure a transfer to himself upon the books of the corporation. For the purpose of ascertaining those who are liable to it for the amount of the assessment, the corporation can look only to the list of stockholders as their names are registered upon its books.

2. The liability of the defendant to the creditors of the corporation for his proportion of their claims against the corporation, and his liability to the corporation for the unpaid portion of his subscription, are entirely distinct, and rest upon different principles. The stockholder is liable to a creditor upon only such liabilities as were incurred during the time he has been a stockholder, but he is liable to the corporation for the unpaid portion of his subscription, whenever the corporation may choose to call it in; and, while the creditor may enforce his claim against the corporation, and seek its entire satisfaction out of the corporate property, he can recover from the stockholder only his proportionate part of the claim. The corporation is authorized to levy an assessment for the express purpose of providing a fund with which to meet its outstanding obligations, and it is no defense to the assessment that the defendant was not a stockholder at the time the obligation was contracted or the liability incurred. Nor is it any defense that the corporation has sufficient property with which to meet its obligations. The liability of the defendant rests upon his contract of subscription, and the propriety or necessity of requiring him to pay it for the purpose of meeting the corporate liabilities, rather than to resort to property in the hands of the corporation with which to meet such liabilities, has been placed in the discretion of the board of directors.

The judgment and order are affirmed.

Garoutte, J., and Van Fleet, J., concurred.

*Note.* There are various holdings as to the liability of the transferor and transferee, after the transfer, to corporate creditors.

Transferor is no longer liable: 1796, Huddersfield Canal Co. v. Buckley, 7 Term Rep. 36; 1821, Franklin Glass Co. v. Alexander, 2 N. H. 380, 9 Am. Dec. 92; 1823, Middletown Bank v. Magill, 5 Conn. 28; 1855, Chouteau Spring Co. v. Harris, 20 Mo. 382; 1880, Johnston v. Laffin, 103 U. S. 800; 1898, White v. Green, 105 Iowa 176; 1899, Rochester, etc., Co. v. Raymond, 158 N. Y. 576; 1899, Efrd v. Piedmont L. I. Co., 55 S. C. 78, 32 S. E. Rep. 758.

Transferor continues liable: 1892, Hood v. McNaughton, 54 N. J. L. 425; 1898, Sprague v. National Bank, 172 Ill. 149, 64 Am. St. Rep. 17; 1899, Ingles Land Co. v. Knoxville F. I. Co., — Tenn. Ch. App. —, 53 S. W. Rep. 1111.

Transferee becomes liable: 1875, Webster v. Upton, 91 U. S. 65; 1896, Wishard v. Hansen, 99 Iowa 307, 61 Am. St. Rep. 238; 1897, Wallace v. Carpenter E. H. Co., 70 Minn. 321, 68 Am. St. Rep. 530; 1898, White v. Green, 105 Iowa 176; 1899, Rochester, etc., Co. v. Raymond, 158 N. Y. 576; 1899, Efrd v. Piedmont L. I. Co., 55 S. C. 78, 32 S. E. Rep. 758.

Transferee who takes without knowledge that shares are not fully paid does not become liable to corporate creditors for the unpaid sums: 1879, Steacy v. R. Co., 5 Dill. 348; 1880, Keystone Bridge Co. v. McCluney, 8 Mo. App. 496; 1887, West Nashville P. M. Co. v. Nashville Savings Bank, 86 Tenn. 252, 6 Am. St. Rep. 835, *infra*, p. 1695; 1898, Sprague v. National Bank, 172 Ill. 149, 64 Am. St. Rep. 17. See 58 L. R. A. 82, 85.

**Sec. 567. Same.** Transfer of unpaid shares to a bona fide purchaser; liability of transferee.

**WEST NASHVILLE PLANING MILL COMPANY v. NASHVILLE SAVINGS BANK.**

1887. IN THE SUPREME COURT OF TENNESSEE. 86 Tenn. Rep. 252, 6 Am. St. Rep. 835.

LURTON, J. The complainant, a manufacturing corporation created under the provisions of the general incorporation act of 1875, sues the defendant upon a stock call duly made for twenty-five per cent. of subscription price upon forty-five shares of stock now standing upon the stock-books of complainant in the name of Julius Sax, president. This stock was originally subscribed by one J. B. Tucker, who paid one-half of the subscription price, but to whom was issued stock certificates, one of which was in the following words:

“Shares \$100 each.

“West Nashville Planing Mill and Lumber Company, Nashville, Tennessee.

“This is to certify that J. B. Tucker is entitled to thirty-five shares, of one hundred dollars each, in the capital stock of the West Nashville Mill and Lumber Company, of Nashville, subject to all the conditions and stipulations contained in their articles of incorporation; transferable by him or his attorney only on surrender of this certificate.

“In testimony whereof, the president and secretary of said company have hereunto subscribed their names.

“R. F. WOODARD, President.

“T. O. TREANOR, Secretary.”

The defendant bank, without notice that the stock was not in fact paid up, and in good faith, made a loan to Tucker, and took his stock certificates as collateral security, with usual power of attorney to transfer same. Subsequently, the bank surrendered original certificates, and caused new certificates to issue to itself, identical in form with the original. Under these facts, defendant must be treated as if an innocent purchaser for value, without actual notice of the fact that the stock was subject to future calls for unpaid balance of subscription price. A number of defenses to this suit have been very ably and earnestly pressed by the solicitor for the bank, but in the view we take of the case, we need only determine one of them. The general rule concerning the effect of the transfer of shares in a corporation is, that such transfer operates as a novation of the contract of membership. The transferrer ceases to be a shareholder, and the transferee becomes one. The first is ordinarily relieved from all further liability to contribute capital, and loses all right to participate in the further profit or management; the transferee takes the place of the retiring member, and by implication assumes all the obligations which



rested upon the former holder as a member of the company, and ordinarily becomes liable for calls to the same extent as the former owner before the transfer was made. Assuming the burdens, he becomes likewise entitled to all the benefits attaching to ownership of the shares. In the absence of charter provisions or statutory regulations, this general rule is almost universally recognized. Morawetz on Corporations, 2d ed., section 159, and authorities cited.

It is clearly so settled in this state. *Jackson v. Sligo M. & M. Co.*, 1 Lea 213; *Moses v. Ocoee Bank*, 1 Lea 398.

Stockholders become such in several ways,—either by original subscription, or by assignment of prior holders, or by direct purchase from the company. It is not at all essential that at the time there is an original subscription there shall be an express promise to pay the subscription price. Oftener than otherwise there is none, the subscription being a simple agreement to take so many shares of stock. By necessary implication, there arises from such a subscription a promise to pay the par value of such stock, upon which an action of *assumpsit* lies. *East Tenn., etc., R. R. v. Gammon*, 5 Sneed 570.

The Massachusetts and Maine cases, holding an express promise necessary are exceptional, and are based chiefly upon the charter remedy of a sale of the stock being regarded as exclusive in the absence of an expressed agreement to pay. The liability of the transferee of unpaid stock is expressly put upon the same ground of an agreement by implication from the acceptance of a transfer of unpaid stock, thus coming into privity with the corporation, and by implication rendering himself liable to action by the corporation for subsequent calls for unpaid balance of subscription price: Morawetz on Corporations, 2d ed., 159; *Webster v. Upton*, 91 U. S. 65.

The Pennsylvania cases, holding that the transferee is not liable without express agreement, are exceptional, and do not commend themselves to us by their reasoning.

The general incorporation act of 1875, under which complainant holds its charter, contains nothing which affects the question of the ordinary liability of a transferee to the corporation. Section 5 of that act only provides for the continued liability of the transferrer in the case mentioned.

As we have seen, the rule which makes a transferee liable for unpaid calls is based upon the implied agreement arising where one takes shares subject to calls, and causes them to be transferred to himself. But where the purchaser of such shares buys them as paid-up shares, and without notice that in fact they are not paid up, then no implication arises of an agreement to pay anything to the corporation for such shares. In such case there are no facts from which to imply an agreement. The representation made by the corporation, either upon the face of the stock certificate or by its officers, that the shares are paid up will, as between the corporation and such transferee, prevent any contract by implication: Morawetz on Corporations, section 161; Cook on Stocks, sections 50, 257, 418.

The question arising upon the certificates in this case is not so easy of solution, inasmuch as there is no express declaration on the face of

it that the shares are non-assessable or paid up. In such a case the question is a perplexing one as to whether the purchaser of such shares is bound, at his peril, to make inquiry, or whether he is not protected by the want of notice.

This certificate is in the usual commercial form of certificates issued for shares fully paid up. There is no intimation upon its face that it is not what it appears to be. The corporation, in putting such shares upon the market, has put it in the power of the subscriber to sell the same to persons innocent of the true fact. Under such circumstances, ought the corporation to be suffered to demand from an innocent transferee, for value, the balance of the subscription price? Certificates of stock are *quasi*-negotiable securities. The vast number of such shares daily sold upon the market have led the courts to aid their commercial and negotiable character in favor of purchasers without notice of secret liens.

Thus an assignment of a certificate of stock is held to pass the legal title to such shares to the assignee, even without transfer upon stock-book or other notice to the corporation: *Cornick v. Richards*, 3 Lea 1.

Again, this court held that if the pledgee of a stock certificate, with blank power of attorney, subpledged such certificate for money loaned, the subpledgee, if ignorant of the title of his pledgor, will hold the certificate as against the true owner. *Cherry v. Frost*, 7 Lea 1.

In view of the important character assumed by shares of stock in both the speculative and investment markets, and in view of the readiness with which corporations can guard themselves, as well as purchasers of such shares by using only fully paid shares, or by expressing upon the face of such as are not paid up the fact that they are subject to call for unpaid subscription price, we hold, in the interest of the negotiability of such shares and of what we deem a true public policy, that a *bona fide* purchaser of a certificate of stock, for value, and without notice, either from the face of the certificate or otherwise, that the subscription price has not been paid, will be protected as between himself and the corporation negligently issuing such shares. This rule we regard as most in accord with the usages, customs, and demands of commerce, and as calculated to prevent the assumption of unsuspected liabilities on the one hand, and the illegitimate use of unpaid shares of stock on the other. *Cook on Stocks*, sections 50, 257.

This rule is in analogy with the principles governing contracts, as there can be no implied contract to pay unpaid calls where the purchaser buys what he is entitled to believe are paid-up shares.

The decree of the chancellor is affirmed.

*Note.* See note, preceding case.

As to effect of transfer upon a corporate lien on shares, see: 1893, *Bank of Atchison v. Durfee*, 118 Mo. 431, 40 Am. St. Rep. 396; 1897, *Boyd v. Redd*, 120 N. C. 335, 58 Am. St. Rep. 792; 1898, *Dorr v. Life Ins. Co.*, 71 Minn. 38, 70 Am. St. Rep. 309; 1899, *Stafford v. Produce Ex. Bk. Co.*, 61 O. S. 160, 76 Am. St. Rep. 371, note 374; 1900, *Bronson Elec. Co. v. Rheubottom*, 122 Mich. 608, 81 N. W. Rep. 563.

Sec. 568. Same. (g) Refusal to transfer,—remedy.

CUSHMAN v. THAYER MANUFACTURING JEWELRY COMPANY.<sup>1</sup>

1879. IN THE COURT OF APPEALS OF NEW YORK. 76 N. Y.  
Rep. 365-373, 32 Am Rep. 315.

[Action to compel the corporation to transfer certain shares to plaintiff and issue a new certificate to her. The original certificate was issued to plaintiff's husband, who, on January 26, 1875, executed in blank and without consideration an assignment and power of attorney (one Beals being a witness) upon the back of the certificate, and delivered it to plaintiff, who filled up the blanks properly, presented it to the company, offered to surrender it, demanded a transfer to her upon the books, and a new certificate. These were refused, upon the ground that plaintiff's husband had, after the assignment to plaintiff, assigned the same shares to Beals for a valuable consideration, and caused the same to be transferred to Beals upon the books. The stock was transferable only upon the books of the company upon surrender of the certificate. Judgment below in favor of plaintiff.]

MILLER, J. The right of the plaintiff to maintain this action depends upon the question whether an equitable action will lie to compel a transfer of stock by a corporation to the owner of the same, or the plaintiff must seek a remedy by an action at law for damages. The latter action is frequently of no avail, and does not always afford complete and full redress. It is easy to see that a party may have become the owner or purchaser of stock in a corporation, which he desires to hold as a permanent investment, which may be at the time of but little value, in fact without any market value whatever, and its real worth may consist in the prospective rise which the owner has reason to anticipate will follow from facts within his knowledge. To say that the holder shall not be entitled to the stock, because the corporation, without any just reason, refuses to transfer it, and that he shall be left to pursue the remedy of an action for damages, in which he can recover only a nominal amount, would establish a rule which must work great injustice in many cases, and confer a power on corporate bodies which has no sanction in the law. A court of equity will enforce a specific performance on a contract for the sale of real estate, and compel the execution of a deed by the vendor to the vendee, although an action at law may be brought to recover damages for the breach of the contract. Such a case bears a striking analogy to the one now presented, and the same principle is manifestly applicable where the remedy at law is inadequate to furnish the proper relief.

That an equitable action will lie, in such a case, has been distinctly recognized in a number of the adjudicated cases in this state. In *Middlebrook v. The Merchants' Bank* (41 Barb. 481, 27 How. 474) the action was brought to compel the bank to allow the transfer of certain

<sup>1</sup> Statement abridged, arguments and part of opinion omitted.

shares of bank stock to the plaintiff. A decree was made directing the transfer, and upon appeal to the court of appeals, the judgment of the supreme court was affirmed. (3 Abb. App. Dec. 295.) No question was raised in either of the courts as to the right to maintain the action; and it is said, in the opinion of the court of appeals: "His" (the plaintiff's) "right was perfect and his demand wrongfully refused." As no point was made that the action did not lie, it is fair to assume that it was conceded that it could be maintained. In the *Com. Bank of Buffalo v. Kortright* (22 Wend. 348), it was held that an action of assumpsit lies against a corporation for damages for refusing to permit a transfer of stock on its books. The chancellor, who dissented from a majority of the court, in his opinion says that the plaintiff might still file a bill to have a sale of the pledge and to compel the bank to allow a transfer of the stock to the purchaser. The decision of the case did not turn on the question now considered; and hence, the point was not decided, and the remarks of the chancellor are only entitled to weight as the opinion of a judge learned and distinguished in this department of law. In *Pollock v. The National Bank* (3 Seld. 274), it was held that a bank which has permitted a transfer of stock owned by a stockholder, upon a forged power of attorney, and has canceled the original certificates, may be compelled to issue new certificates; and if it has no shares which it can so issue, to pay the value thereof. If, in such a case, new certificates may be decreed to be issued, surely it should be done where the right of the owner is entirely clear. The action was of an equitable character, and the principle decided recognizes the right to compel a transfer of stock by the bank. In *Purchase v. N. Y. Ex. Bank* (3 Robt. 164), it was held that after an assignment of bank stock, the bank, upon the application of the *owner*, is bound to allow the transfer to be made on its books, and to issue a new certificate, unless restrained by the order of a court of competent jurisdiction. In *White v. Schuyler* (1 Abb. Pr. N. S. 300), it was held that specific performance of an agreement to transfer stock may be decreed, where the contract to convey is clear, and the uncertain value of the stock renders it difficult to do justice by an award of damages. The specific objection that the party had a remedy at law was not taken, although the point was in the case. The question was considered in the opinion of Hogeboom, J., and numerous authorities cited to sustain the principle laid down. The same rule is held in the case of *Buckmaster v. The Consumers' Ice Co.* (5 Daly 313). These cases show a recognition of the principle that a court of equity will interfere when the remedy is defective at law, if such an interference be not against equity and good conscience. See *Seymour v. Delancey* (6 Johns. Ch. 222, 3 Cow. 445).

While the general rule is for courts of equity not to entertain jurisdiction for a specific performance on the sale of stock, this rule is limited to cases where a compensation in damages would furnish a complete and satisfactory remedy. (*Phillips v. Berger*, 2 Barb. 608; *Story's Eq. Jur.*, § 717.) Judge Story, in section 717, states, as the reason why a contract for stock is not specifically decreed, that "it is

ordinarily capable of such an exact compensation." He further says: "But cases of a peculiar stock may easily be supposed, where courts of equity might still feel themselves bound to decree a specific performance, upon the ground that, from its nature, it has a peculiar value, and is incapable of compensation by damages." He also says, in regard to the general rule as to jurisdiction, in section 718: "The rule is a qualified one, and subject to exceptions; or, rather, the rule is limited to cases where a compensation in damages furnishes a complete and satisfactory remedy." The case considered comes directly within the exception stated. A recovery of damages would furnish inadequate compensation; the remedy by mandamus can not be invoked, as the authorities hold, and there can be no question that, in a case of this kind, a court of equity alone can grant the proper relief.

It is insisted that when the plaintiff demanded a transfer on the books of the company the stock had already been transferred to another person, who had paid a money consideration to the plaintiff's husband, from whom she claimed, and the remedy, if any, was by an action for damages. We think that the transfer alleged, under the circumstances, was not a valid one as against the plaintiff, and furnishes no sufficient answer to the plaintiff's claim, if, as we have seen, she had a right to maintain an action in equity to compel a transfer of the stock to her. Her right was paramount to that which the defendant seeks to interpose as a defense. The stock had previously, and on the 19th of January, 1875, been transferred to her by an assignment indorsed on the back of the certificate, and on the same day a power of attorney had been executed by the owner to her, which authorized the plaintiff to act for him and in his behalf. That the transfer was made without a moneyed consideration can make no difference, as it was otherwise valid. The assignments to Beals, which, it is claimed, are entitled to priority, bore date some time after the transfer to the plaintiff. As they were subsequent to such transfer, and as by the certificate the stock was only transferable upon the books of the company upon a surrender of the same, no title could pass unless the transfer was thus made. The delivery of the certificate, as between the owner and assignee, with the assignment and power indorsed, passes the entire legal and equitable title in the stock, subject only to such liens or claims as the corporation may have upon it. (*McNeil v. The Tenth National Bank*, 46 N. Y. 331; *N. Y. & N. H. R. Co. v. Schuyler*, 34 N. Y. 30, 80.) Any act suffered by the corporation that invested a third party with the ownership of the shares, without due production and surrender of the certificate, rendered it liable to the owner; and it was its duty to resist any transfer on the books without such production and surrender. (*Smith v. The American Coal Co. of Allegheny Co.*, 7 Lans. 317; see, also, *N. Y. & N. H. R. Co. v. Schuyler*, 34 N. Y. 83.) Beals was a witness to the original assignment to the plaintiff, was an officer of the company, and took the transfer to himself with full knowledge of plaintiff's claim, for a very trifling consideration, and in fraud



of plaintiff's rights as the owner of the stock. In view of the facts, Beals has no reason for questioning the plaintiff's title; and the defendant certainly has no valid grounds for claiming that Beals was the owner instead of the plaintiff. \* \* \*

*Affirmed.*

*Note.* The general rule is, that where stock can be procured upon the market, an action at law for damages, as for a conversion of shares, is an adequate remedy, and therefore neither mandamus, nor a suit in equity can be maintained. As to the circumstances under which the corporation becomes liable, either for refusal to transfer shares or for an improper transfer, see, 1857, *Mandlebaum v. N. A. Min. Co.*, 4 Mich. 464; 1878, *Telegraph Co. v. Davenport*, 97 U. S. 369; 1883, *Moore v. Citizens' Bank*, 111 U. S. 156; 1887, *Supply Ditch Co. v. Elliott*, 10 Colo. 327, 3 Am. St. Rep. 586; 1889, *Allen v. South Boston R.*, 150 Mass. 200; 1890, *Rice v. Rockefeller*, 134 N. Y. 174; 1892, *Peck v. Providence Gas Co.*, 17 R. I. 275; 1893, *Fifth Ave. Bank v. 42d St. R.*, 137 N. Y. 231; 1896, *Knox v. Eden Musee Am. Co.*, 148 N. Y. 441; 1897, *Cincinnati, etc., R. Co. v. Citizens' Nat'l Bank*, 56 Ohio St. 351.

## Sec. 569. Same. Mandamus.

IN THE MATTER OF MORRIS SHIPLEY AND OTHERS v. THE MECHANICS' BANK.

1813. IN THE SUPREME COURT OF NEW YORK. 10 Johns. (N. Y.) Rep. 484-5.

A motion was made for a mandamus, to be directed to the president, directors and company of the Mechanics' Bank, commanding them to permit Morris Shipley and others, assignees of Samuel Kip, to transfer eight shares of the capital stock of the bank standing on the books of the company.

It appeared from the affidavits read, that Kip had been regularly discharged under the insolvent act, and that Shipley and others had been duly appointed the assignees of all his estate, real and personal, and that the *shares* in question were inserted in the *inventory* of his estate exhibited by the insolvent. The assignees applied to the company to be permitted to transfer the shares, which the company refused, on the ground that Kip was indebted to them in the sum of \$1,474.60 for money lent, etc., and at the time held the eight shares to the value of twenty-five dollars each, which they claimed the right of retaining and applying towards paying the debt due to them from Kip.

*Per Curiam.* The applicants have an adequate remedy, by a special action on the case, to recover the value of the stock if the bank have unduly refused to transfer it. There is no need of the extraordinary remedy by mandamus in so ordinary a case. It might as well be required in every case where trover would lie. It is not a matter of public concern, as in the case of public records and documents; and there can not be any necessity, or even a desire of possess-



ing the identical shares in question. By recovering the market value of them, at the time of the demand, they can be replaced. This is not the case of a specific and favorite chattel, to which there might exist the *pretium affectionis*. The case of *The King v. The Bank of England* (Doug. 524) is in point, and this remedy in that case was denied.

Motion denied.

*Note. Accord:* 1807, *Gray v. Portland Bank*, 3 Mass. 364; 1870, *Baker v. Marshal*, 15 Minn. 177; 1870, *State v. Rombauer*, 46 Mo. 155; 1872, *Kimball v. Union Water Co.*, 44 Cal. 173; 1872, *Murray v. Stevens*, 110 Mass. 95; 1879, *Stackpole v. Seymour*, 127 Mass. 104; 1881, *Bank v. Harrison*, 66 Ga. 696; 1882, *Townes v. Nichols*, 73 Me. 515; 1884, *Freon v. Carriage Co.*, 42 Ohio St. 30, 51 Am. Rep. 794, note, 798; 1889, *Burnsville Tp. Co. v. State*, 119 Ind. 382, 3 L. R. A. 265, note; 1899, *Durfee v. Harper*, 22 Mont. 354. See, also, note *supra*, p. 1319, and preceding case.

But when there is no adequate remedy by the ordinary processes of the law, mandamus may be had. See note *supra*, p. 1319; 1858, *People v. Crockett*, 9 Cal. 113; 1870, *State v. Cheraw & Darlington R. Co.*, 2 S. C. (N. S.) 25; 1873, *Green Mountain Tp. Co. v. Bulla*, 45 Ind. 1; 1881, *People v. Goss & Phillips Mfg. Co.*, 99 Ill. 355; 1881, *State v. Cheraw & Chester R.*, 16 S. C. 524; 1883, *State v. First Nat'l Bank*, 89 Ind. 302; 1886, *In re Klaus*, 67 Wis. 401; 1892, *Slemmons v. Thompson*, 23 Ore. 215.

## Sec. 570. Same.

### PRATT v. BOSTON AND ALBANY RAILROAD COMPANY.

1879. IN THE SUPREME JUDICIAL COURT OF MASSACHUSETTS.  
126 Mass. Rep. 443-445.

[Bill in equity alleging certain facts, and praying that the defendant company be ordered to procure and transfer to the plaintiff five shares of its capital stock, issue to her a proper certificate therefor, make proper record thereof on the books, and pay her dividends declared thereon since January 11, 1876. Defendant demurred for non-joinder of parties,—this was overruled and an appeal taken.]

GRAY, C. J. The bill alleges, and the demurrer admits, that, without any negligence or any authority of the plaintiff, a certificate of five shares owned by her in the defendant corporation, having indorsed thereon a forged power of attorney to Brown to transfer the shares to Richardson, Hill and Company, was presented and surrendered by Brown to the corporation, and the shares were transferred by Brown to Richardson, Hill and Company, and that the corporation thereupon issued a new certificate for these shares to Richardson, Hill and Company, who claim to hold the same. The bill does not seek to cancel that certificate, or ask for any relief which may require a decree against Richardson, Hill and Company, or against Brown; but prays that the corporation may procure five shares of its capital stock, and record and issue to the plaintiff a certificate thereof, and pay to her the dividends thereon.

The corporation, by its unauthorized and illegal act, has clearly made itself liable to the plaintiff; and her right to maintain this bill against the corporation is wholly independent of the questions whether it has also made itself liable to Richardson, Hill and Company upon the new certificate, and whether it can maintain any action against them or against Brown by reason of their having obtained that certificate by means of a forged paper. It was therefore rightly held that neither of them was a necessary party to the bill. *Pratt v. Taunton Copper Co.*, 123 Mass. 110; *Machinists' Bank v. Field*, 126 Mass. 345; *Salisbury Mills v. Townsend*, 109 Mass. 115; *Loring v. Salisbury Mills*, 125 Mass. 138; *Telegraph Co. v. Davenport*, 97 U. S. 369; *Dalton v. Midland R.*, 12 C. B. 458; *Duncan v. Luntley*, 2 Macn. & Gord. 30, s. c. 2 Hall & Twells 78; *Taylor v. Midland R.*, 28 Beav. 287, and 8 H. L. Cas. 751.

*Decree affirmed.*

*Note.* See, 1897, *Kerr v. Urie*, 86 Md. 72, 38 L. R. A. 119; 1899, *Real Estate Trust Co. v. Bird*, 90 Md. 229, 44 Atl. Rep. 1048.

## Sec. 571. 6. Right to participate in issue of new stock.

### DOUSMAN v. THE WISCONSIN AND LAKE SUPERIOR MINING AND SMELTING COMPANY.<sup>1</sup>

1876. IN THE SUPREME COURT OF WISCONSIN. 40 Wis. Rep. 418-423.

[Plaintiff alleged he was the owner of seven shares in the company, all of which were fully paid; that there were 131 shares of \$500 each, none of which (except plaintiff's shares and one other) were more than half paid up. Under authority it was determined to increase the stock to 1,000 shares, of which 250 were to be used in performing a contract with another corporation, 95 shares reserved to the company, and the other 655 shares issued to the shareholders,—five shares fully paid for each share of the old stock. Plaintiff alleged that the company refused to allow him any greater interest for his fully-paid shares than was allowed to a like number of half-paid shares; he asked that he be allowed new shares, in proportion to the amount paid, or that half of those issued to holders of half-paid stock be canceled. The facts were found as alleged, and further distribution was enjoined, unless the issue of new shares were made in proportion demanded by plaintiff.]

RYAN, C. J. 1. The injury which the respondent, as a shareholder of the appellant, sets up in his complaint, is one peculiar and personal to himself, not common to other shareholders, alleged to have been committed by the board of directors, as the governing body of the corporation; that is, by the corporation itself. Clearly his

<sup>1</sup> Statement abridged, part of opinion omitted.

remedy is against the corporation. Probably he might have maintained an action at law against it. *Gray v. Portland Bank*, 3 Mass. 364. But the effect of such an action would be to convert part of his interest as a shareholder into a judgment for damages; in other words, to sell a portion of his stock to the corporation. That he is not obliged to do. He has a right to maintain his proportionate interest in the corporation, certainly as long as there is sufficient stock remaining undisposed of by the corporation. Trading corporations of the character of the appellant have been likened to partnerships, and the remedies of stockholders to those of partners, by very high authority. *Gray v. Portland Bank*, *supra*; *Robinson v. Smith*, 3 Paige 222; *Adley v. Whitstable Co.*, 17 Vesey 315. And equity has always afforded a remedy to a stockholder, in such a case as this, by injunction, account, or other appropriate decree. *Adley v. Whitstable Co.*, *supra*. This principle has been repeatedly recognized in this court, as in *Putnam v. Sweet*, 2 Pin. 302; *Nazro v. Ins. Co.*, 14 Wis. 319.

Such a case is clearly distinguishable from suits by stockholders in the right of the corporation, founded on wrongs against the corporation. In that class of cases, as the authorities cited by the appellant show, the right of suit is primarily in the corporation itself; and stockholders take the right, in lieu of the corporation, only upon refusal of the governing body of the corporation to sue.

Here the wrong complained of is by the corporation, not against it. The right is against it, not against individual directors. The judgment, to be effectual, must be against the corporation itself; not against the directors personally, who may be changed from time to time. And even where a suit would lie by a corporation against its governing body for wrongs done against it by the governing body, it is sufficiently manifest that a demand upon the governing body to bring the suit would be nugatory.

2. If there are other shareholders in like condition as the respondent, their right and his are several; they may bring their separate suits, or they may submit to the wrong at their several pleasure. The respondent has no right to represent them. The case is entirely distinguishable from a wrong done by the governing body common to all the stockholders. \* \* \*

*Affirmed.*

*Note.* See, 1807, *Gray v. Portland Bank*, 3 Mass. 364, 3 Am. Dec. 156; 1855, *Reese v. Bank of Montgomery Co.*, 31 Pa. St. 78, 72 Am. Dec. 726; 1871, *Eidman v. Bowman*, 58 Ill. 444, 11 Am. Rep. 90; 1876, *State v. Smith*, 48 Vt. 266; 1883, *Jones v. Morrison*, 31 Minn. 140; 1891, *Jones v. Concord, etc., R.*, 67 N. H. 119; 1892, *Jones v. Concord, etc., R.*, 67 N. H. 234, 68 Am. St. Rep. 650; 1892, *Humboldt, etc., Park Assn. v. Stevens*, 34 Neb. 528, 33 Am. St. Rep. 654, note; 1893, *Baltimore, etc., R. v. Hambleton*, 77 Md. 341, *supra*, p. 1582; 1899, *Real Estate Trust Co. v. Bird*, 90 Md. 229, 44 Atl. Rep. 1048; 1901, *Electric Co. of America v. Edison Elec. Co.*, — Pa. St. —, 50 Atl. 164.

Compare, 1879, *Terry v. Eagle Lock Co.*, 47 Conn. 141; 1882, *Mason v. Davol Mills*, 132 Mass. 76; 1886, *Pratt v. Telephone Co.*, 141 Mass. 225, 55 Am. Rep. 465; 1897, *Meredith v. New Jersey Zinc Co.*, 55 N. J. Eq. 211; 1902, *Crosby v. Stratton*, — Col. App. —, 68 Pac. 130.

**Sec. 572.** 7. Right to be released from corporate liability:  
(a) For fraud or mistake in inducing subscriptions.

See *Martin v. South Salem L. Co.*, 94 Va. 28, *supra*, p. 539, note 544; *Rockford, R. I. & St. L. R. Co. v. Shunick*, 65 Ill. 223, *supra*, p. 545, note 547.

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**Sec. 573. Same.** (b) In case the requisite amount of stock is not subscribed.

See *Anderson v. Middle & E. T. Central R. Co.*, 91 Tenn. 44, *supra*, p. 511, note 514.

*Note.* See, 1827, *Salem Mill Dam Corp. v. Ropes*, 6 Pick. 23; 1839, *Pitchford v. Davis*, 5 M. & W. 2; 1900, *McCoy v. World's Columb. Ex.*, 186 Ill. 356, 78 Am. St. Rep. 288.

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**Sec. 574. Same.** (c) By a material change in the business of the corporation.

See *Ashton v. Burbank*, 2 Dill. 435, Fed. Cas. No. 582, *supra*, p. 87; *Railway Company v. Allerton*, 18 Wall. 233, *supra*, p. 442.

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**Sec. 575. Same.** (d) By a forfeiture of shares for non-payment.

See *Small v. Herkimer Mfg. Co.*, 2 N. Y. 330, *supra*, p. 1567; *Budd v. Multnomah St. Ry. Co.*, 15 Ore. 413, *supra*, p. 1569.

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**Sec. 576. Same.** (e) By a valid and completed transfer of shares.

See *Visalia & Tulare R. Co. v. Hyde*, 110 Cal. 632, *supra*, p. 1692, and note, p. 1694; *West Nashville Planing Mill Co. v. Nashville Savings Bank*, 86 Tenn. 252, *supra*, p. 1695.

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**Sec. 577.** 8. Right to enjoin a change in the corporate enterprise, unless such power is reserved to the state.

See *Railway Company v. Allerton*, 18 Wall. 233, *supra*, p. 442; *Durfee v. Old Colony, etc., R.*, 5 Allen (Mass.) 230, *supra*, p. 1462; *Zabriskie v. Hackensack, etc., R.*, 18 N. J. Eq. 178, *supra*, p. 1466.

**Sec. 578. 9. Right to share in distribution of surplus assets upon dissolution of the corporation.**

See *Bacon v. Robertson*, 18 How. 480, *supra*, p. 899; *Foster v. Essex Bank*, 16 Mass. 245, *supra*, p. 895; *Wilson v. Leary*, 120 N. C. 90, *supra*, p. 903. See, also, note, *supra*, p. 910; and compare *State Bank v. State*, 1 Blackf. 267, *supra*, p. 891; *Titcomb v. Kennebunk Mut. F. Ins. Co.*, 79 Me. 315, *supra*, p. 901; *Romney v. United States*, 136 U. S. 1, *supra*, p. 906.

**Sec. 579. 10. Right to sue for wrongs done to the corporation.**  
(a) General doctrine, as to action at law.

JOSEPH SMITH v. JOHN HURD, ET AL.<sup>1</sup>

1847. IN THE SUPREME JUDICIAL COURT OF MASSACHUSETTS. 12  
Metc. (Mass.) Rep. 371-387.

[Special action on the case by a stockholder in the Phoenix Bank against the directors, charging them with non-feasance of official duty in negligently permitting the president to control the whole business, and to loan large sums of money without reasonable security and misfeasance in paying an excessive salary to the president, making dividends when there were no profits, causing false returns of the condition of the bank to be made to the secretary of the commonwealth, and false exhibits to the bank examiners, by all of which plaintiff was misled into purchasing ninety shares of stock in addition to the ten shares he originally subscribed for; and further that the directors so "fraudulently mismanaged the bank that the whole capital thereof was utterly lost and destroyed." Defendants demurred.]

SHAW, C. J. This is certainly a case of first impression. We are not aware that any similar action has been sustained in England, or in any of the courts of this country. It is founded on no statute. It is an action on the case, at common law, brought by an individual holder of shares in an incorporated bank against the directors, not including the president, setting forth various acts of negligence and malfeasance, through a series of years, in consequence of which, as the declaration alleges, the whole capital of the bank was wasted and lost, and the shares of the plaintiff became of no value. The circumstance that no such action has been maintained would certainly be no decisive objection if it could be shown to be maintainable on principle. But the fact that similar grievances have existed to a great extent, and in numberless instances, where such an action would have presented an obvious and effective remedy, affords strong proof that, in the view of all such suffering parties, and their legal advisers and guides, there was no principle on which such an action can be maintained.

<sup>1</sup> Statement abridged; arguments omitted.

If an action can be brought by one stockholder, it may be brought by the holder of a single share; so that for one and the same default of these directors, thirty-five hundred actions might be brought. If it may be sustained by proof of an act, or series of acts, of carelessness, neglect, and breach of duty, in managing the affairs of the bank, by which the whole value of the stock is destroyed, it may, on the same principle, be maintained on any act or instance of such negligence, by which the shares are diminished in value fifty, ten, five or one per cent. Still, notwithstanding these consequences, if the plaintiff has a good right of action, upon recognized and sound legal principles, his action ought to be sustained.

But the court are of opinion that the action can not be maintained; and that on several grounds, a few of the more prominent of which may be alluded to.

1. There is no legal privity, relation, or immediate connection, between the holders of shares in a bank, in their individual capacity, on the one side, and the directors of the bank on the other. The directors are not the bailees, the factors, agents or trustees of such individual stockholders. The bank is a corporation and body politic, having a separate existence as a distinct person in law, in whom the whole stock and property of the bank are vested, and to whom all agents, debtors, officers and servants are responsible for all contracts, express or implied, made in reference to such capital, and for all torts and injuries diminishing or impairing it. The very purpose of incorporation is to create such legal and ideal person in law, distinct from all the persons composing it, in order to avoid the extreme difficulty, and perhaps it is not too much to say, the utter impracticability, of such a number of persons acting together in their individual capacities. The practical difficulty would be nearly as great, whether it were held that all must join in an action to recover damage for an injury to the common property, or that each might sue separately.

The stockholders do, indeed, ordinarily elect the directors; but it is as parts and members of the corporation, in their corporate capacity, in modes pointed out by the charter and by-laws, so that the directors are the appointees of the corporation, not of the individuals. Indeed, I believe there is a provision in the bank charters—there certainly was formerly—which is equally to the present purpose; namely, that the commonwealth shall be at liberty to add a certain amount to the capital of various banks and appoint a proportional number of directors. Such directors so appointed, pursuant to the charter regulating the legal organization of the body, would stand in all respects on the footing of directors chosen by the stockholders. If these were liable to the action of individual stockholders those would be in like manner.

2. The individual members of the corporation, whether they should all join or each act severally, have no right or power to intermeddle with the property or concerns of the bank, or call any officer, agent or servant to account or discharge them from any liability. Should all the stockholders join in a power of attorney to any one,



he could not take possession of any real or personal estate, any security or chose in action, could not collect a debt or discharge a claim, or release damage arising from any default, simply because they are not the legal owners of the property, and damage done to such property is not an injury to them. Their rights and their powers are limited and well defined. They are members of an organized body, and exercise such powers as the organization of the institution gives them. Stockholders in banks have a separate right to dividends, when declared, and to a distributive share of the capital stock, if any remains when the charter of the bank is at an end and its debts paid.

3. But another important consideration is, that the injury done to the capital stock by wasting, impairing and diminishing its value, is not, in the first instance, nor necessarily, a damage to the stockholders. All sums which could, in any form, be recovered on that ground, would be assets of the corporation, and when collected and received by directors, receivers, or any other persons entitled to receive the same, they would be held in trust, first to redeem the bills and pay the debts of the bank; and it would be only after these debts were paid, and in case any surplus should remain, that the stockholders would be entitled to receive anything. It is, therefore, an indirect, contingent and subordinate interest, which each stockholder has in damages so to be recovered against directors. If, upon such indirect, contingent and remote interest, individual stockholders could recover for the defaults of directors, and especially, as is alleged in this case, where these defaults have been so great as to sink the capital, *a fortiori* would the creditors of the bank individually have a right to maintain similar actions; because their claim upon the funds, being prior to that of stockholders, would be somewhat more immediate and direct.

In the same connection, it is obvious to remark, that a judgment in favor of one stockholder would be no bar to an action by a creditor, nor a judgment by both, to an action by the corporation.

4. But it is said that although the real and personal estate, the securities and capital stock, are, in legal contemplation, vested in the corporation, yet the individual has a separate and distinct property and interest in his particular shares, by any injury to which he may have a separate damage. To some extent it is true that he has a several interest in his shares, but it is to be taken with some qualifications. Strictly speaking, shares in a bank do not constitute a legal estate and property; it is rather a limited and qualified right which the stockholder has to participate, in a certain proportion, in the benefits of a common fund, vested in a corporation for the common use; it is a qualified and equitable interest, a valuable interest, manifested usually by a certificate, which is transferable. To the extent of this separate and peculiar interest, a stockholder, no doubt, might maintain his separate and special action, according to the nature of the wrong done to him in respect to it; as trover or trespass, for the conversion or tortious taking of his certificate; trespass on the case for

refusing to make a transfer on a proper occasion; assumpsit for a dividend declared, and the like. But an injury done to the stock and capital, by negligence or misfeasance, is not an injury to such separate interest, but to the whole body of stockholders in common. It is like the case of a common nuisance, where one who suffers a special damage, peculiar to himself, and distinguishable in kind from that which he shares in the common injury, may maintain a special action. Otherwise, he can not. Co. Lit. 56a; 3 Steph. N. P. 2372; Lansing v. Smith, 8 Cow. 146.

But we are pressed with the argument that for every damage which one sustains, which is caused by the wrongful act of another, he ought to have a remedy. This is far from being universally true. Another maxim in regard to claims for damages is, *causa proxima, non remota, spectatur*. Thousands of instances occur in which one sustains consequential and incidental damage from the misconduct of another, without a remedy at law. By the misconduct of the officers or agents of a parish, town, county, or even of the state or the Union, defalcations may take place, treasure be squandered and wasted, and all the members of the respective aggregate bodies suffer damage, for which the law, from the nature of the case, can afford no direct remedy. But the true answer to the objection is, that stockholders have a remedy, a theoretic one, indeed, and perhaps often inadequate, in the power of the corporation, in its corporate capacity, to obtain redress for injuries done to the common property, by the recovery of damages; and each individual stockholder has his remedy, through the powers thus vested in the corporation for the common benefit.

On the whole, the court are of opinion that the demurrer is well taken, and that the action can not be maintained.

*Note.* See note, *infra*, p. 1723, and 1899, Home M. Co. v. McKibben, 60 Kan. 387; 1903, Home Ins. Co. v. Barber, — Neb. —, 60 L. R. A. 927.

## Sec. 580. Same. (b) Suits in equity.

See Dodge v. Woolsey, 18 Howard (U. S.) 331, *supra*, p. 88.

See note, *supra*, p. 96, and *infra*, p. 1723.

## Sec. 581. Same. General rule and exceptions.

### RUSSELL v. WAKEFIELD WATER-WORKS COMPANY.<sup>1</sup>

1875. IN THE ENGLISH CHANCERY. L. R. 20 Eq. Cas. 474-483.

[Bill by Russell, on behalf of himself and all the other shareholders (except those made defendants) of the Water-works Company, against it, its six directors and the six promoters of a new company,

<sup>1</sup> Statement abridged; arguments omitted.

asking that the directors and promoters be required to pay back to the company £5,500, alleged to have been paid out of the company's funds by its directors to buy off the promoters of the new company from securing an act of parliament to enable them to operate in the same district. The bill was demurred to.]

SIR GEORGE JESSEL, M. R. I am of opinion that this bill is open to general demurrer on two grounds. The nature of the case which I suppose was intended to be made by the bill is that the water-works company were not authorized to pay a sum of £5,500 to the promoters of an opposition company, who were opposing a bill for extending the powers of what I will call the old company, in order to buy off the opposition. The bill seeks to make liable both the directors of the old company who had paid the money and the promoters of the new company who received the money.

The two objections, which I think are well founded, are these: First, it is said there is no case made by the bill showing that the act complained of was beyond the powers of the old company, there being no direct allegation of fraud, although the word "corrupt" is used; and secondly, it is said that, even if the act complained of was shown to be *ultra vires*, it was a case in which the old company, which was an incorporated company, ought to sue.

(His honor then reviewed the allegations in the bill, and considered that the bill did not sufficiently allege that the payment complained of was beyond the powers of the old company.)

A great deal of the argument in this case turned upon what may be described, perhaps, in one sense, as a technical objection, but which is a very formidable and important objection. It was said that this is a bill to make a stranger pay back money belonging to a company which the stranger has illegally or improperly possessed himself of, or appropriated to his own use, and that any person who takes possession of a trust fund is liable to be sued in equity by the owner of the trust fund if he had notice at the time that it was a trust fund; and although he gave value, still in that way the bill can be maintained against him.

The answer was, that where the owner of the trust fund is an incorporated company, the corporation is the only party to sue; the stranger has nothing whatever to do with the individual corporators; and although in a sense it is their property, because individual corporators make up the corporation, yet in law it is not their property, but the property of the corporation, and therefore the right person to sue is the corporation, who is the *cestui que trust* or equitable owner of the fund. That I take to be the general rule of this court. In this court the money of the company is a trust fund, because it is applicable only to the special purposes of the company in the hands of the agents of the company, and it is in that sense a trust fund applicable by them to those special purposes; and a person taking it from them with notice that it is being applied to other purposes can not in this court say that he is not a constructive trustee.

But the general rule being that the *cestui que trust* must sue, and

not the individual corporator who has only an ultimate beneficial interest, the only point remaining to be considered is, whether there are any exceptions to the general rule. I entirely agree that the general rule, if I may say so respectfully, is correctly stated by Lord Justice James in the case of *Gray v. Lewis*, Law Rep. 8 Ch. App. 1035, 1050: "Where there is a corporate body capable of filing a bill for itself to recover property, either from its directors or officers, or from any other person, that corporate body is the proper plaintiff, and the only proper plaintiff." I do not understand the Lord Justice to intend to state more than the general rule; because he began by saying: "It is very important, in order to avoid oppressive litigation, to adhere to the rule laid down in *Mozley v. Alston*, 1 Ph. Ch. 790, and *Foss v. Harbottle*, 2 Hare 461, which cases have always been considered as settling the law of this court." So that in laying down the general rule he did not intend to impeach or interfere with those cases, but only to express the result of them. In reality *Mozley v. Alston*, 1 Ph. Ch. 790, simply affirmed *Foss v. Harbottle*, and therefore when you want to find the rule you must look to *Foss v. Harbottle*, where you will find the general rule is that which I have stated. But that is not a universal rule; that is, it is a rule subject to exceptions, and the exceptions depend very much on the necessity of the case; that is, the necessity for the court doing justice.

In *Foss v. Harbottle*, 2 Hare 491, Vice-Chancellor Sir J. Wigram says this: "The first objection taken in the argument for the defendants was that the individual members of the corporation can not in any case sue in the form in which this bill is framed. During the argument I intimated an opinion, to which, upon a further consideration, I fully adhere, that the rule was much too broadly stated on the part of the defendants. I think there are cases in which a suit might properly be so framed. Corporations like this, of a private nature, are in truth little more than private partnerships, and in cases which may easily be suggested it would be too much to hold that a society of private persons associated together in undertakings which, though certainly beneficial to the public, are nevertheless matters of private property, are to be deprived of their civil rights *inter se* because, in order to make their common objects more attainable, the crown or the legislature may have conferred upon them the benefit of a corporate character. If a case should arise of injury to a corporation by some of its members, for which no adequate remedy remained except that of a suit by individual corporators in their private characters, and asking in such character the protection of those rights to which in their corporate character they were entitled, I can not but think that the principle so forcibly laid down by Lord Cottenham, in *Wallworth v. Holt*, 4 My. & C. 619, 635, and other cases, would apply, and the claims of justice would be found superior to any difficulties arising out of technical rules respecting the mode in which corporations are required to sue." That I take to be the correct law on the subject.

It remains to consider what are those exceptional cases in which, for the due attainment of justice, such a suit should be allowed. We

are all familiar with one large class of cases which are certainly the first exception to the rule. They are cases in which an individual corporator sues the corporation to prevent the corporation either commencing or continuing the doing of something which is beyond the powers of the corporation. Such a bill, indeed, may be maintained by a single corporator, not suing on behalf of himself and of others, as was settled in the house of lords in a case of *Simpson v. Westminster Palace Hotel Company*, 8 H. L. C. 711. If the subject-matter of the suit is an agreement between the corporation acting by its directors or managers and some other corporation or some other person strangers to the corporation, it is quite proper and quite usual to make that other corporation or person a defendant to the suit, because that other corporation or person has an interest, and a great interest, in arguing the question and having it decided, once for all, whether the agreement in question is really within the powers or without the powers of the corporation of which the corporator is a member. So that in these cases you must always bring before the court the other corporation.

The cases are so numerous on this subject that one ought not perhaps to refer to them. But I may mention a few of them. There is, first, the well-known case of *Hare v. London and Northwestern Railway Company*, 2 J. & H. 80; there is the case of *Simpson v. Denison*, 10 Hare 51; there is a case of *Beman v. Rufford*, 1 Sim. (N. S.) 550; and a vast number of cases as regards agreements between railway companies which have been held to be *ultra vires*. When you have got the second corporation or person a party to the suit it may happen that, in addition to the relief that you are entitled to as regards the first, you are entitled to have relief against the second for something that has been done under the *ultra vires* agreement. You may be entitled to have money paid back which has been paid under the *ultra vires* agreement, as in the case of *Salomons v. Laing*, 12 Beav. 377, and you may be entitled to have property returned or other acts done. If the detainer or holder of the money or property, that is, the second corporation or other person, is already a party, and a necessary party, to the suit, it would indeed be a lame and halting conclusion if the court were to say it could do justice in a suit so framed by ordering the money to be returned or the property restored. It is a necessary incident to the first part of the relief which can be obtained by individual corporators, and will do complete justice on each side, and that has always been the practice of the court. Therefore, in a case so framed there is no objection to a suit by an individual corporator to recover from another corporator, or from any other persons being strangers to this corporation, the money or property so improperly obtained. But that is not the only case. Any other case in which the claims of justice require it is within the exception.

Another instance occurred in the case of *Atwool v. Merryweather*, Law Rep. 5 Eq. 464, n., in which the corporation was controlled by the evil-doer, and would not allow its name to be used as plaintiff in

the suit. It was said that justice required that the majority of the corporators should not appropriate to themselves the property of the minority, and then use their own votes at the general meeting of the corporation to prevent their being sued by the corporation, and consequently in a case of that kind the corporators who form part of the minority might file a bill on their own behalf to get back the property or money so illegally appropriated. It is not necessary that the corporation should absolutely refuse by vote at the general meeting, if it can be shown either that the wrong-doer had command of the majority of the votes, so that it would be absurd to call the meeting; or if it can be shown that there has been a general meeting substantially approving of what has been done; or if it can be shown from the acts of the corporation as a corporation, distinguished from the mere acts of the directors of it, that they have approved of what has been done, and have allowed a long time to elapse without interfering, so that they do not intend and are not willing to sue. In all those cases the same doctrine applies, and the individual corporator may maintain the suit. As I have said before, the rule is a general one, but it does not apply to a case where the interests of justice require the rule to be dispensed with. I do not intend by the observations I have made in any way to restrain the generality of the terms made use of by the learned judge who decided the case of *Foss v. Harbottle*, 2 Hare 461. Therefore I can not help seeing it is quite possible so to amend this bill as to get rid of the difficulty which now exists, and I think that on this part of the case I should give leave to amend. Of course, in allowing the demurrer, I allow it in the usual form.

*Note.* See note, *infra*, p. 1723.

## Sec. 582. Same.

BRONSON ET AL. V. LA CROSSE AND MILWAUKEE RAILROAD  
COMPANY ET AL.<sup>1</sup>

1863. IN THE SUPREME COURT OF THE UNITED STATES. 2 Wall.  
(69 U. S.) Rep. 283-312.

[Under a foreclosure sale of third mortgage bonds of the L. & M. R. Co., the M. & M. R. Co. became the owner of the road of the L. & M. Co., subject to prior mortgages. In this suit in equity by Bronson to foreclose the prior second mortgage on the L. & M. road, the M. & M. company was made a party defendant. It failed to put in any answer at the time required, and before an order had been taken *pro confesso* against it for not answering, one R., a shareholder, presented to the court a petition charging fraud and collusion between Bronson and the president of the M. & M. Co., whereby the latter, although requested to defend the company's rights, had declined to do

<sup>1</sup> Statement abridged, arguments omitted. Only the part of the opinion relating to the single point is given.



so. The petition prayed that R. might defend the bill *on the part of said company*. Leave was granted to make defense in the name of the M. & M. Co., and to the same extent as it could. R., however, put in an answer in his own name, whereupon F., another shareholder, upon a like petition, was permitted to put in an answer signed "The M. & M. R. Co., by F., stockholder." Replications were filed to these answers.]

MR. JUSTICE NELSON. As the two stockholders (Rockwell and Fleming), though not made defendants by the bill, were permitted, by leave of the court, to appear and put in answers in the name of the Milwaukee and Minnesota Company, it is material to inquire into the effect to be given to them. That they can not be regarded as the answers of the corporate body is manifest, as a corporation must appear and answer to the bill, not under oath, but under its common seal. And an omission thus to appear and answer, according to the rules and practice of the court, entitles the complainants to enter an order that the bill be taken *pro confesso*. A further objection to the practice of permitting a party to appear and answer in the name of the corporation is the inequality that would exist between the parties to the litigation. The corporation not being before the court, it would not be bound by any order or decree rendered against it, nor by any admissions made in the answer or stipulations that might be entered into by the parties or their counsel. It is thus apparent, that while the name of the corporation is thus used as a real party in the litigation, so far as the rights and interests of the complainants are concerned, it is an unreal and fictitious party so far as respects any obligation or responsibility on the part of the respondents.

It is insisted, however, that the directors of this company refused to appear and defend the bill filed against them, and for the fraudulent purpose of sacrificing the interests of the stockholders; and, hence, the necessity, as well as the propriety and justice, of permitting the defense by a stockholder in their name.

Undoubtedly, in the case supposed, it would be a reproach to the law, and especially in a court of equity, if the stockholders were remediless. But in such a case, the court in its discretion will permit a stockholder to become a party defendant, for the purpose of protecting his own interests against unfounded or illegal claims against the company; and he will also be permitted to appear on behalf of other stockholders who may desire to join him in the defense. But this defense is independent of the company and of its directors, and the stockholder becomes a real and substantial party to the extent of his own interests and of those who may join him, and against whom any proceeding, order, or decree of the court in the cause is binding, and may be enforced. It is true, the remedy is an extreme one, and should be admitted by the court with hesitation and caution; but it grows out of the necessity of the case and for the sake of justice, and may be the only remedy to prevent a flagrant wrong. A complainant, if he chooses, may compel a corporation to appear and answer by a writ of *distringas*; or he may join with the corporation, a di-

rector, or officer, if he desires a discovery under oath. But we are not aware of any other except a complainant who can compel an appearance or answer.

Now, although the appearance and answers of the stockholders (Rockwell and Fleming) were irregularly allowed by the court, as each was permitted to appear and answer in the name of the company, yet, as the defense set up is doubtless the same as that which they would have relied on if they had been admitted simply as stockholders, we are inclined to regard the answers the same as if put in by them in that character, in the further views we shall take of the case. Each one swore to the truth of his answer in the usual way. \* \* \*

*Note.* See note, *infra*, p. 1723; 1902, *Watkins v. North Am. L., etc., Co.*, 106 La. —, 31 So. 683.

**Sec. 583. Same. (c) *Ultra vires* acts.**

**TOMKINSON v. SOUTHEASTERN RAILWAY COMPANY.<sup>1</sup>**

1887. IN CHANCERY DIVISION. L. R. 35 Ch. Div. Rep. 675-681.

[Motion by plaintiff, the owner of £500 of the stock of the S. E. Ry. Co., for an injunction to restrain the company carrying out a resolution of shareholders carried by a vote of 10,229 votes, representing £1,209,035 of stock, against 175 votes, representing £13,500 of stock, to subscribe £1,000 of the company's money to the Imperial Institute. The plaintiff was not present at the meeting, but as soon as he heard of it protested to the secretary, who replied that the directors usually carried out the orders of the shareholders, and that the plaintiff's share of the contribution would be about 13d. After some further correspondence plaintiff began this suit.]

KAY, J. I have no doubt that it is the duty of the court to grant an injunction in this case.

The question, as the attorney-general said, is whether the act proposed to be done is within the powers of the railway company, or outside its powers. If it is outside its powers, it is now perfectly settled that any one shareholder may come to this court and say, "This company is going to do an act which is beyond its power; stop it;" and the court thereupon has no discretion in the matter.

Now, what is proposed to be done here is this: The chairman of the railway company, at a meeting of the company, proposed this resolution: "That the directors [of the company] be authorized, either by way of donation from the company or by an appeal to the proprietors as they may be advised"—the resolution thus proposing two alternative modes—"to subscribe the sum of £1,000 to the Imperial Institute." I pause there. The Imperial Institute has no more connection with this railway company than the present exhibition of pictures at Burlington House, or the Grosvenor Gallery, or Madam Tussaud's, or

<sup>1</sup> Statement abridged. Only a small part of opinion given.

any other institution in London that can be mentioned. The only ground for the suggestion that this company has the right to apply its funds, which it has been allowed to raise for specific purposes, to this purpose, is, that the Imperial Institute, if it succeeds, will very probably greatly increase the traffic of this company. If that is a good reason, then, as I pointed out during the argument, any possible kind of exhibition which, by being established in London, would probably increase the traffic of the railway company by inducing people to come up to see it, would be an object to which a railway company might subscribe part of its funds. I never heard of such a rule, and, as far as I understand the law, that clearly would not be a proper application of the money of a railway company. I can not distinguish this case from that at all, though, of course, I do not mean to disparage the enormous importance of the Imperial Institute. It may be established for the highest possible objects of interest to this country; but still, the only reason given to me why this railway company thinks it right to spend part of its funds in subscribing to it is this, that it will probably greatly increase the traffic of the company by inducing many people to travel up to visit this Institute. I can not accept that as a reason for a moment. Therefore, as at present advised, it seems to me that this is *ultra vires*. \* \* \*

*Injunction granted.*

*Note.* See note, *infra*, p. 1723.

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**Sec. 584. Same. (d)** Causes for which, and circumstances under which shareholders may sue.

#### HAWES v. OAKLAND.

1881. IN THE SUPREME COURT OF THE UNITED STATES. 104 U. S. Rep. 450-462.

MR. JUSTICE MILLER. This is an appeal from a decree in chancery dismissing the complainant's bill, wherein he, a citizen of New York, alleges that he is a stockholder in the Contra Costa Waterworks Company, a California corporation, and that he files it on behalf of himself and all other stockholders who may choose to come in and contribute to the costs and expenses of the suit.

The defendants are the City of Oakland, the Contra Costa Waterworks Company, and Anthony Chabot, Henry Pierce, Andrew J. Pope, Charles Holbrook, and John W. Coleman, trustees and directors of the company.

The foundation of the complaint is that the city of Oakland claims at the hands of the company water, without compensation, for all municipal purposes whatever, including watering the streets, public squares and parks, flushing sewers, and the like, whereas it is only entitled to receive water free of charge in cases of fire or

other great necessity; that the company comply with this demand, to the great loss and injury of the company, to the diminution of the dividends which should come to him and other stockholders, and to the decrease in the value of their stock. The allegation of his attempt to get the directors to correct this evil will be given in the language of the bill.

He says that "on the tenth day of July, 1878, he applied to the president and board of directors or trustees of said water company, and requested them to desist from their illegal and improper practices aforesaid, and to limit the supply of water free of charge to said city to cases of fire or other great necessity, and that said board should take immediate proceedings to prevent said city from taking water from the works of said company for any other purpose without compensation; but said board of directors and trustees have wholly declined to take any proceedings whatever in the premises, and threaten to go on and furnish water to the extent of said company's means to said city of Oakland free of charge, for all municipal purposes, as has heretofore been done, and in cases other than cases of fire or other great necessity, except as for family uses hereinbefore referred to; and your orator avers that by reason of the premises said water company and your orator and the other stockholders thereof have suffered, and will, by a continuance of said acts, hereafter suffer, great loss and damage."

To this bill the water-works company and the directors failed to make answer; and the city of Oakland filed a demurrer, which was sustained by the court and the bill dismissed. The complainant appealed.

Two grounds of demurrer were set out and relied on in the court below, and are urged upon us on this appeal. They are:

(1) That appellant has shown no capacity in himself to maintain this suit, the injury, if any exists, being to the interests of the corporation, and the right to sue belonging solely to that body.

(2) That by a sound construction of the law under which the company is organized the city of Oakland is entitled to receive, free of compensation, all the water which the bill charges it with so using.

The first of these causes of demurrer presents a matter of very great interest, and of growing importance in the courts of the United States.

Since the decision of this court in *Dodge v. Woolsey*,<sup>1</sup> the principles of which have received more than once the approval of this court, the frequency with which the most ordinary and usual chancery remedies are sought in the federal courts by a single stockholder of a corporation who possesses the requisite citizenship, in cases where the corporation whose rights are to be enforced can not sue in those courts, seems to justify a consideration of the grounds on which that case was decided, and of the just limitations of the exercise of those principles.

<sup>1</sup> 18 How. 331, *supra*, p. 88.

This practice has grown until the corporations created by the laws of the states bring a large part of their controversies with their neighbors and fellow-citizens into the courts of the United States for adjudication, instead of resorting to the state courts, which are their natural, their lawful, and their appropriate forum. It is not difficult to see how this has come to pass. A corporation having such a controversy, which it is foreseen must end in litigation, and preferring for any reason whatever that this litigation shall take place in a federal court, in which it can neither sue its real antagonist nor be sued by it, has recourse to a holder of one of its shares, who is a citizen of another state. This stockholder is called into consultation, and is told that his corporation has rights which the directors refuse to enforce or to protect. He instantly demands of them to do their duty in this regard, which of course they fail or refuse to do, and thereupon he discovers that he has two causes of action entitling him to equitable relief in a court of chancery; namely, one against his own company, of which he is a corporator, for refusing to do what he has requested them to do; and the other against the party which contests the matter in controversy with that corporation. These two causes of action he combines in an equity suit in the circuit court of the United States, because he is a citizen of a different state, though the real parties to the controversy could have no standing in that court. If no non-resident stockholder exists, a transfer of a few shares is made to some citizen of another state, who then brings the suit. The real defendant in this action may be quite as willing to have the case tried in a federal court as the corporation and its stockholder. If so, he makes no objection, and the case proceeds to a hearing. Or he may file his answer denying the special grounds set up in the bill as a reason for the stockholder's interference, at the same time that he answers to the merits. In either event the whole case is prepared for hearing on the merits, the right of a stockholder to a standing in equity receives but little attention, and the overburdened courts of the United States have this additional important litigation imposed upon them by a simulated and conventional arrangement, unauthorized by the facts of the case or by the sound principles of equity jurisdiction.

That the vast and increasing proportion of the active business of modern life which is done by corporations should call into exercise the beneficent power and flexible methods of courts of equity, is neither to be wondered at nor regretted; and this is especially true of controversies growing out of the relations between the stockholder and the corporation of which he is a member. The exercise of this power in protecting the stockholder against the frauds of the governing body of directors or trustees, and in preventing their exercise, in the name of the corporation, of powers which are outside of their charters or articles of association, has been frequent, and is most beneficial, and is undisputed. These are real contests, however, between the stockholder and the corporation of which he is a member.

The case before us goes beyond this.

This corporation, like others, is created a body politic and corporate, that it may in its corporate name transact all the business which its charter or other organic act authorizes it to do.

Such corporations may be common carriers, bankers, insurers, merchants, and may make contracts, commit torts, and incur liabilities, and may sue or be sued in their corporate name in regard to all of these transactions. The parties who deal with them understand this, and that they are dealing with a body which has these rights and is subject to these obligations, and they do not deal with or count upon a liability to the stockholder whom they do not know and with whom they have no privity of contract or other relation.

The principle involved in the case of *Dodge v. Woolsey* permits the stockholder in one of these corporations to step in between that corporation and the party with whom it has been dealing and institute and control a suit in which the rights involved are those of the corporation, and the controversy is one really between that corporation and the other party, each being entirely capable of asserting its own rights.

This is a very different affair from a controversy between the shareholder of a corporation and that corporation itself, or its managing directors or trustees, or the other shareholders, who may be violating his rights or destroying the property in which he has an interest. Into such a contest the outsider, dealing with the corporation through its managing agents in a matter within their authority, can not be dragged, except where it is necessary to prevent an absolute failure of justice in cases which have been recognized as exceptional in their character and calling for the extraordinary powers of a court of equity. It is, therefore, always a question of equitable jurisprudence, and as such has, within the last forty years, received the repeated consideration of the highest courts of England and of this country.

The earliest English case in which this subject received any very careful consideration is *Foss v. Harbottle*, 2 Hare 461, where Vice-Chancellor Wigram gave a very full and able opinion. The case was decided in 1843 on a demurrer to the bill, which was brought by Foss and Turton, two shareholders in an incorporation called the Victoria Park Company, on behalf of themselves and all other stockholders, except those who were made defendants, against the directors and one shareholder not a director, and against the solicitor and architect of the company. The bill charged that the defendants concerted and effected various fraudulent and illegal transactions, whereby the property of the company was misapplied, aliened, and wasted; that there had ceased to be sufficient number of qualified directors to constitute a board; and that the company had no clerk or office. It prayed for the appointment of a receiver and for a decree against the defendants to make good the loss. After showing that the case was one in which the right of action was in the company, the Vice-Chancellor says: "In law the corporation and the aggregate members of the corporation are not the same thing for purposes like this; and the only question can be, whether the facts alleged in this case justify a departure from the rule, which *prima facie* would require that the corporation



should sue in its own name and in its corporate character, or in the name of some one whom the law has appointed to be its representative." Again, after pointing out that cases may arise where the claims of justice would be found superior to the technical rules respecting the mode in which corporations are required to sue, he adds:

"But, on the other hand, it must not be without reasons of a very urgent character that the established rules of law and practice are to be departed from,—rules which, though in a sense technical, are founded on the general principles of justice and convenience; and the question is, whether a case is stated in this bill entitling the plaintiffs to sue in their private characters." He then, in an elaborate argument, holds that the bill is fatally defective because it does not aver that there is no acting or *de facto* board of directors who might have ordered the bringing of this suit; and, secondly, that it was the duty of the plaintiffs—the two shareholders who complain of what had been done—to have called a meeting of the shareholders or attended at some regular annual meeting, and obtained the action of a majority on the matters in issue. The majority, he says, may have been content with what was done, and may have ratified the action of the board, in which case the whole body would have been bound by it.

The demurrer was sustained and the bill dismissed.

In the subsequent case of *Mozley v. Alston*, 1 Ph. Ch. 790, decided in 1847, Lord Chancellor Lyndhurst says that "the observations of the Vice-Chancellor in *Foss v. Harbottle* correctly represent what is the principle and practice of the court in reference to suits of this description."

These cases have been referred to again and again in the English courts as leading cases on the subject to which they relate, and always with approval.

In *Gray v. Lewis*, L. R. 8 Ch. App. 1035, decided in 1873, Sir W. M. James, L. J., said: "I am of opinion that the only person, if you may call it a person, having a right to complain was the incorporated society called Charles Lafitte & Co. In its corporate character it was liable to be sued and was entitled to sue; and if the company sued in its corporate character, the defendant might allege a release or a compromise by the company in its corporate character,—a defense which would not be open in a suit where a plaintiff is suing on behalf of himself and other shareholders. I think it is of the utmost importance to maintain the rule laid down in *Mozley v. Alston*, and *Foss v. Harbottle*, to which, as I understand, the only exception is where the corporate body has got into the hands of directors, and of the majority, which directors and majority are using their power for the purpose of doing something fraudulent against the minority, who are overpowered by them, as in *Atwool v. Merryweather*. L. R. 5 Eq. 464n, where Vice-Chancellor Wood sustained a bill by a shareholder on behalf of himself and others, and there it was after an attempt had been made to obtain proper authority from the corporate body itself in a public meeting assembled."

But perhaps the best assertion of the rule and of the exceptions to it are found in the opinion of the court by the same learned justice in *MacDougall v. Gardiner*, 1 Ch. D. 13, in 1875. "I am of opinion," he says, "that this demurrer ought to be allowed. I think it is of the utmost importance in all these controversies that the rule, which is well known in this court as the rule in *Mozley v. Alston*, and *Lord v. Copper Miners' Company*, and *Foss v. Harbottle*, should always be adhered to; that is to say, that nothing connected with internal disputes between shareholders is to be made the subject of a bill by some one shareholder on behalf of himself and others, unless there be something illegal, oppressive or fraudulent; unless there is something *ultra vires* on the part of the company *qua* company, or on the part of the majority of the company, so that they are not fit persons to determine it, but that every litigation must be in the name of the company, if the company really desire it. Because there may be a great many wrongs committed in a company,—there may be claims against directors, there may be claims against officers, there may be claims against debtors; there may be a variety of things which a company may well be entitled to complain of, but which, as a matter of good sense, they do not think it right to make the subject of litigation: and it is the company, as a company, which has to determine whether it will make anything that is a wrong to the company a subject-matter of litigation, or whether it will take steps to prevent the wrong from being done."

The cases in the English courts are numerous, but the foregoing citations give the spirit of them correctly.

In this country the cases outside of the federal courts are not numerous, and while they admit the right of a stockholder to sue in cases where the corporation is the proper party to bring the suit, they limit this right to cases where the directors are guilty of a fraud or a breach of trust, or are proceeding *ultra vires*. *Marsh v. Eastern R. R. Co.*, 40 N. H. 548; *Peabody v. Flint*, 6 Allen (Mass.) 52. In *Brewer v. Boston Theater*, 104 Mass. 378, the general doctrine and its limitations are very well stated. See, also, *Hersey v. Veazie*, 24 Me. 9; *Samuel v. Holladay*, 1 Woolw. 400.

The case of *Dodge v. Woolsey*,<sup>1</sup> decided in this court in 1855, is, however, the leading case on the subject in this country.

(After examining and commenting upon this case, proceeds.)

This examination of *Dodge v. Woolsey* satisfies us that it does not establish, nor was it intended to establish, a doctrine on this subject different in any material respect from that found in the cases in the English and in other American courts, and that the recent legislation of congress referred to leaves no reason for any expansion of the rule in that case beyond its fair interpretation.

We understand that doctrine to be that to enable a stockholder in a corporation to sustain, in a court of equity, in his own name, a suit founded on a right of action existing in the corporation itself, and in which the corporation itself is the appropriate plaintiff, *there must exist as the foundation of the suit—*

*Some action or threatened action of the managing board of direc-*

<sup>1</sup> *Supra*, p. 88.

*tors or trustees of the corporation which is beyond the authority conferred on them by their charter or other source of organization;*

*Or such a fraudulent transaction completed or contemplated by the acting managers, in connection with some other party, or among themselves, or with other shareholders, as will result in serious injury to the corporation, or to the interests of the other shareholders;*

*Or where the board of directors, or a majority of them, are acting for their own interest, in a manner destructive of the corporation itself, or of the rights of the other shareholders;*

*Or where the majority of shareholders themselves are oppressively and illegally pursuing a course in the name of the corporation, which is in violation of the rights of the other shareholders, and which can only be restrained by the aid of a court of equity.*

Possibly other cases may arise in which, to prevent irremediable injury, or a total failure of justice, the court would be justified in exercising its powers, but the foregoing may be regarded as an outline of the principles which govern this class of cases.

But, *in addition to the existence of grievances* which call for this kind of relief, it is equally important that before the shareholder is permitted in his own name to institute and conduct a litigation which usually belongs to the corporation, *he should show to the satisfaction of the court that he has exhausted all the means within his reach to obtain, within the corporation itself, the redress of his grievances, or action in conformity to his wishes. He must make an earnest, not a simulated, effort, with the managing body of the corporation, to induce remedial action on their part, and this must be made apparent to the court. If time permits, or has permitted, he must show, if he fails with the directors, that he has made an honest effort to obtain action by the stockholders as a body, in the matter of which he complains. And he must show a case, if this is not done, where it could not be done, or it was not reasonable to require it.*

The efforts to induce such action as complainant desires on the part of the directors, and of the shareholders when that is necessary, and the cause of failure in these efforts should be stated with particularity, and an allegation that complainant was a shareholder at the time of the transactions of which he complains, or that his shares have devolved on him since by operation of law, and that the suit is not a collusive one to confer on a court of the United States jurisdiction in a case of which it could otherwise have no cognizance, should be in the bill, which should be verified by affidavit.

It is needless to say that appellant's bill presents no such case as we have here supposed to be necessary to the jurisdiction of the court.

He merely avers that he requested the president and directors to desist from furnishing water free of expense to the city, except in case of fire or other great necessity, and that they declined to do as he requested. No correspondence on the subject is given; no reason for declining. We have here no allegation of a meeting of the directors, in which the matter was formally laid before them for action; no attempt to consult the other shareholders, to ascertain their opinions or

obtain their action. But within five days after his application to the directors this bill is filed. There is no allegation of fraud or of acts *ultra vires*, or of destruction of property, or of irremediable injury of any kind.

Conceding appellant's construction of the company's charter to be correct, there is nothing which forbids the corporation from dealing with the city in the manner it has done. That city conferred on the company valuable rights by special ordinance; namely, the use of the streets for laying its pipes, and the privilege of furnishing water to the whole population. It may be the exercise of the highest wisdom to let the city use the water in the manner complained of. The directors are better able to act understandingly on this subject than a stockholder residing in New York. The great body of the stockholders residing in Oakland or other places in California may take this view of it, and be content to abide by the action of their directors.

If this be so, is a bitter litigation with the city to be conducted by one stockholder for the corporation and all other stockholders, because the amount of his dividends is diminished?

This question answers itself, and without considering the other point raised by the demurrer, we are of opinion that it was properly sustained, and the bill dismissed, because the appellant shows no standing in a court of equity—no right in himself to prosecute this suit.

*Decree affirmed.*

*Note.* Upon the general doctrine as to when and for what wrongs shareholders may sue for wrongs done to the corporation, see, 1843, *Foss v. Harbottle*, 2 Hare 461; 1855, *Dodge v. Woolsey*, 18 How. 331, *supra*, p. 88; 1859, *Burt v. British, etc., Assn.*, 4 De G. & J. 158, 61 Eng. Ch. 158; 1861, *Forrest v. Manchester S. & L. R.*, 4 De G., F. & J. 126; 1863, *Peabody v. Flint*, 6 Allen (Mass.), 52; see, *supra*, p. 1706; 1867, *Atwood v. Merryweather*, L. R. 5 Eq. 464, note; 1873, *Dudley v. Kentucky High School*, 9 Bush (Ky.) 576; 1873, *Davenport v. Dows*, 18 Wall. 626; 1874, *Menier v. Hooper's Tel. Works*, L. R. 9 Ch. App. 350; 1875, *Russell v. Wakefield W.-W.*, L. R. 20 Eq. 474, *supra*, p. 1709; 1875, *MacDougall v. Gardiner*, 1 Ch. D. 13; 1879, *Mason v. Harris*, 11 Ch. D. 97; 1892, *Willoughby v. Chicago Jct. R.*, 50 N. J. Eq. 656; 1895, *Eaton v. Robinson*, 19 R. I. 146; 1896, *Elyton L. C. v. Dowdell*, 113 Ala. 177, 59 Am. St. Rep. 105; 1896, *Decatur Min. & L. Co. v. Polen*, 113 Ala. 531, 59 Am. St. Rep. 140; 1896, *Farmers' L. & T. Co. v. N. Y. & N. R. Co.*, 150 N. Y. 410, 55 Am. St. Rep. 689; 1898, *Cameron v. Groveland Imp. Co.*, 20 Wash. 169, 72 Am. St. Rep. 26, note, 29; 1898, *Blair v. Tel. Newspaper Co.*, 172 Mass. 201, 51 N. E. 1080; 1898, *Stahn v. Catawba Mills*, 53 S. C. 519, 31 S. E. 498; 1899, *State v. Dist. Ct. of Silverbow Co.*, 22 Mont. 220, 56 Pac. Rep. 219; 1899, *Reynolds v. Bank of Mt. Vernon*, 158 N. Y. 740; 1899, *Dillon v. Lee*, 110 Iowa 156, 81 N. W. Rep. 245; 1899, *Ulmer v. Maine Real Estate Co.*, 93 Maine 324, 45 Atl. Rep. 40; 1899, *Wineburgh v. U. S. Steam, etc., Co.*, 173 Mass. 60, 73 Am. St. Rep. 261; 1899, *Arkansas B. & L. Assn. v. Madden*, 175 U. S. 269; 1900, *Spaulding v. N. M. T. S. Co.*, 106 Wis. 481, 81 N. W. Rep. 1064; 1900, *Center Creek Water and Ir. Co. v. Lindsay*, 21 Utah 192, 60 Pac. Rep. 559; 1900, *Wolf v. Pennsylvania R.*, 195 Pa. St. 91, 45 Atl. Rep. 936; 1900, *Cunningham v. Wechselberg*, 105 Wis. 359, 81 N. W. Rep. 414.

Demand upon the corporate authorities for redress through corporate means or in the corporate name is usually necessary: 1884, *Dimpfell v. Railway Co.*, 110 U. S. 209; 1888, *Dunphy v. Travelers' Assn.*, 146 Mass. 495; 1898, *Robinson v. W. Va. Loan Co.*, 90 Fed. Rep. 770; 1898, *Clarke v. Eastern*

Building Assn., 89 Fed. Rep. 779; 1898, Exter v. Sawyer, 146 Mo. 302, 47 S. W. Rep. 951; 1898, Weir v. Bay State Gas Co., 91 Fed. Rep. 940; 1899, Jasper Land Co. v. Wallis, 123 Ala. 652, 26 So. 659; 1899, Montgomery L. Co. v. Lahey, 121 Ala. 131, 25 So. Rep. 1006; 1899, Flynn v. Brooklyn C. R., 158 N. Y. 493; 1899, Blair v. Newspaper Co., 172 Mass. 201; 1900, Wolf v. Pennsylvania R. Co. 195 Pa. St. 91, 45 Atl. Rep. 936; 1903, Niles v. N. Y. C., &c. R. Co., 176 N. Y. 119.

What is sufficient demand, see, 1899, Ball v. Rutland R. Co., 93 Fed. Rep. 513; 1899, Jasper Land Co. v. Wallis, 123 Ala. 652, 26 So. Rep. 659.

Demand upon the corporation is unnecessary if the officers themselves who control corporate action are the guilty parties, or the court has jurisdiction on other grounds, or if the corporation itself could not enforce the claim or demand—and generally when the act is an *ultra vires* corporate act: 1863, Bronson v. La C. & M. R., 2 Wall. 283, *supra*, p. 1713; 1890, Eschweiler v. Stowell, 78 Wis. 316, 23 Am. St. Rep. 411; 1892, Hannerty v. Standard Theater Co., 109 Mo. 297, 19 S. W. Rep. 82; 1892, Chicago, etc., Cab Co. v. Yerkes, 141 Ill. 320, 33 Am. St. Rep. 315, note 325; 1898, Barcus v. Gates, 89 Fed. Rep. (C. C. A.) 783; 1898, Rogers v. Nashville, etc., R., 91 Fed. Rep. 299; 1898, Old Colony Trust Co. v. Dubuque, etc., Co., 89 Fed. Rep. 794; 1898, Pencille v. State F. M. H. Ins. Co., 74 Minn. 67, 73 Am. St. Rep. 326, 76 N. W. Rep. 1026; 1898, Forrester v. Min. Co., 21 Mont. 544; 1899, Harding v. Am. Glucose Co., 182 Ill. 551, 74 Am. St. Rep. 189; 1899, Hodges' Admx. v. South F. L. Co., 21 Ky. L. Rep. 20, 50 S. W. Rep. 969; 1900, Shively v. Eureka T. G. M. Co., 129 Cal. 293, 61 Pac. Rep. 939; 1900, Fitzwater v. Nat'l Bank, 62 Kan. 163, 61 Pac. Rep. 684; 1900, State v. Holmes, 60 Neb. 40, 82 N. W. Rep. 109.

Suits by shareholders to restrain *ultra vires* acts, see, 1862, Durfee v. Old Colony R. Co., 5 Allen 230, *supra*, p. 1462; 1867, Zabriskie v. Hackensack, etc., R. Co., 18 N. J. Eq. 178, *supra*, p. 1466; 1887, Tompkinson v. S. E. R. Co., L. R. 35 Ch. D. 675; 1899, Davis v. Congregation, etc., 40 App. Div. 424.

Compare, 1884, Dimpfell v. R. Co., 110 U. S. 209; 1899, Burden v. Burden, 159 N. Y. 287.

As to multifariousness of bill, see, 1875, Winsor v. Bailey, 55 N. H. 218; 1888, Dunphy v. Travelers' Assn., 146 Mass. 495; 1900, South Bend Chilled Plow Co. v. Cribb, 105 Wis. 443, 81 N. W. Rep. 675.

The corporation is a necessary party: 1898, Edwards v. Bay State Gas Co., 91 Fed. Rep. 946. See Quincy v. Steel Co., 120 U. S. 241 (pleading).

## Sec. 585. Same. (c) Good faith of shareholder.

### PARSONS v. JOSEPH.

1890. IN THE SUPREME COURT OF ALABAMA. 92 Ala. Rep. 403-407.

[Bill by Joseph, a stockholder in a street railroad company, to have certain certificates of stock canceled.]

COLEMAN, J. The purpose of the bill is to have certain certificates of stock issued by the Birmingham, Powderly and Bessemer Street Railroad Company to defendant Parsons canceled, on the ground that the stock is fictitious, and was issued in violation of the constitution and statute law of the state. The bill prayed an injunction and the writ was awarded by the chancellor. A demurrer was interposed, and also an answer by the defendant Parsons. The cause was submitted for decree on the demurrer and upon motion to dissolve the injunction. The court overruled the demurrer and denied the motion to dissolve the injunction, and from this interlocutory decree the appeal is taken.



Among other averments, the bill substantially alleges that plaintiff is a *bona fide* stockholder in said company; that shortly after organization of the company, the defendant subscribed for one hundred and seven shares of the capital stock of the company, of the par value of fifty dollars each, and paid for the same in full by conveying to the company thirty-nine acres of land (describing the land) at an agreed price and valuation of one hundred and thirty-seven dollars per acre, when the land was not worth more than twenty-five dollars per acre, and for this land Parsons was to receive one hundred and seven shares of the stock; that shortly thereafter, the capital stock of the company was doubled, and without further consideration than the thirty-nine acres of land, Parsons' stock was doubled, and he received two hundred and fourteen shares of the capital stock. The bill, as amended, charges the excessive valuation of the land was made knowingly, willfully, and with the fraudulent intent of having issued to Parsons the fictitious stock, in violation of law. This is a sufficient statement of the facts for the consideration of the demurrer.

The demurrer admits the truth of the averments. It is contended that the bill is defective in not averring that plaintiff was a stockholder at the time of the transaction complained of as being fraudulent, or that his stock devolved upon him by operation of law.

In the case of *Dimpfell v. Ohio & Mississippi R. Co.*, 110 U. S. 209, relied upon by appellant, it was held that a stockholder, contesting as *ultra vires* an act of the directors, should aver "that he was a stockholder at the time of the transaction of which he complains, or that his shares have devolved on him since by operation of law." To the same effect was *Hawes v. Oakland*, 104 U. S. 450, and many others might be cited. Upon an examination of these authorities it will be seen that the principle asserted rests solely upon equity Rule No. 94, adopted by the United States supreme court, and which may be found in the preface to volume 104 of U. S. report. *Morawetz on Private Corporations*, speaking of this rule, says it was evidently designed as a rule of practice merely, and was deemed necessary to guard courts from being imposed upon by collusion of parties. *Morawetz on Priv. Corp.*, §§ 269, 270. The rule is not a general principle of law, applicable to pleadings in all the courts, and has never been applied to the courts of this state. The demurrer to the bill for failing to make this averment was properly overruled.

The motion to dissolve the injunction was heard upon the sworn bill and answer. The answer denied that plaintiff was a *bona fide* stockholder, and set up that plaintiff was the transferee of one E. Lesser. The answer admits that the defendant's stock was doubled without the payment of any additional consideration than that of the land; but by way of explanation and defense, avers that the lands were not truly and properly valued at first, and the increased valuation of the lands only raised them to their real and true value, and the additional issue of stock was for property at its fair valuation. The answer continues, however, as follows: That if said transaction had been illegal and fraudulent, and not done in good faith, complainant is es-



topped from setting up fraud in said transaction, or seeking to cancel said stock, because E. Lesser, who was complainant's transferrer, participated in all of said transactions and himself fixed the value of said lands, with full knowledge and after full investigation of the value of said lands.

A transferee of stock is not necessarily disqualified as a suitor in all cases because the prior holders were personally disqualified. If the transferee purchased the shares in good faith, and without notice of the fact that the prior holder had precluded himself from suing, he would have as just a title to relief as if he had purchased from a shareholder who was under no disability; but if the purchaser was aware that the prior holder had barred his right to relief, neither justice nor public policy would require that the transferee, under these circumstances, should be accorded any greater rights than his transferrer. Morawetz, *supra*, § 267.

The same rule prevails in this state in favor of derivative purchasers. The claimant, who was a *bona fide* purchaser, without notice of fraud, or of facts which the law considers sufficient to establish it, or from which it is inferable, then he could not be affected by notice to his vendor. Horton v. Smith, 8 Ala. 78; Fenno v. Sayre, 3 Ala. 458; Wier v. Davis, 4 Ala. 442; Martinez v. Lindsey, 91 Ala. 334; Wait on Insol. Cor., §§ 628, 630.

If a stockholder participates in a wrongful or fraudulent contract, or silently acquiesces until the contract becomes executed, he can not then come into a court of equity to cancel the contract, and more especially if the company, or himself, as a stockholder, has reaped a benefit from the contract; and this rule holds good, although the consideration of the contract may be one expressly prohibited by statute. The same disability would attach to the transferee of his stock who bought with notice. We consider this general rule of equity abundantly sustained. Morawetz on Priv. Corp., §§ 261, 262; Cook on Stock and Stockholders, §§ 39, 40, 735; Wright v. Hughes, 12 Am. St. Rep. 413. It is sustained by the familiar rule that he who invokes the aid of a court of equity must have clean hands. Mr. Cook states the conditions upon which a stockholder can sustain a suit to remedy the frauds, *ultra vires* acts or negligence of directors, to be: *First*, the acts complained of must be such as to amount to a breach of trust, and such as neither a majority of the directors nor of the stockholders can ratify or condone; *second*, that the complaining stockholder himself is free from *laches*, acquiescence of the acts to remedy which the suit is brought; *third*, that the corporation has been requested and refused or neglected to institute the suit, that the suit is instituted by *bona fide* stockholders as complainants, and that the corporation and the guilty parties, and other proper parties, have been made defendants. Cook, *supra*, § 646.

If the averments of the bill are sustained by proof, the stock issued to the defendants was in violation of section 1662 of the code, and of section 6, article XIV, of the constitution. On the contrary, if the proof shows that the property was received in payment of stock,

at a fair valuation, such would not be the result. *Davis Bros. v. Montgomery Fur and Chem. Co.*, at present term.

In cases where the stockholders or the company by any *laches*, acquiescence or participation in the unlawful and fictitious issue of stock, or for any other sufficient cause, are precluded from instituting the proper proceedings to remedy the wrong, the remedy is still open to the state to institute all necessary and proper proceedings to vacate and dissolve the corporation, or have such other proper judgment and decree rendered as the proof and justice may demand.

It may be that stockholders, who knowingly and intentionally have subscribed and paid for stock with property upon a fictitious valuation, are liable as stockholders who have not paid up in full for their stock, within the meaning of the statute, to creditors who have not precluded themselves from maintaining the suit. *Wait, supra*, § 593; *Douglas v. Ireland*, 73 N. Y. 100; *Boynton v. Andrews*, 63 N. Y. 93.

Applying the rule of law applicable when a motion to dissolve an injunction is submitted upon bill, exhibits, and answer, and considering only so much of the answer as is responsive to the bill, we are of opinion that the decretal order, overruling the demurrers and motion to dissolve the injunction, is free from error.

Affirmed.

*Note.* See, 1867, *Seaton v. Grant*, L. R. 2 Ch. App. 459; 1898, *Green v. Hedenberg*, 159 Ill. 489, 50 Am. St. Rep. 178; 1900, *Morris v. Elyton Land Co.*, — Ala. —, 28 So. Rep. 513.

Compare, 1883, *Parsons v. Hayes*, 14 Abb. N. C. 419; 1898, *Robinson v. W. Va. Loan Co.*, 90 Fed. Rep. 770. Also, *Hawes v. Oakland, supra*, p. 1716.

### SUBDIVISION III. THE CORPORATION AND ITS OFFICERS.

#### ARTICLE I. RIGHTS OF THE CORPORATION.

#### Sec. 586. 1. General doctrine.

*Smith v. Hurd*, 12 Metc. (Mass.) 371, *supra*, p. 1706.

#### Sec. 587. Same. 2. Theories of the relation of the directors and the corporation.

(a) Agents of the corporation, and not trustees of the shareholders.

#### ALLEN v. CURTIS.<sup>1</sup>

1857. IN THE SUPREME COURT OF ERRORS OF CONNECTICUT. 26 Conn. Rep. 456-461.

Action on the case, brought by a stockholder of the Woodbury Bank against the defendants, as directors thereof. The declaration

<sup>1</sup> Arguments and part of opinion omitted.

alleged that on the 27th day of September, 1852, the stockholders of the Woodbury Bank appointed the defendants directors thereof, who accepted the trust and undertook to manage and conduct its business and financial affairs in a prudent and skillful manner, but that they did not so conduct the affairs of the bank, but on the contrary willfully and designedly managed the same in an unskillful, careless and reckless manner, making false entries in the books of the bank, loaning money without security, etc., whereby the bank became insolvent, and the stock of the plaintiff wholly worthless and a total loss. The declaration contained three counts substantially alike, the third containing a more direct averment of fraud in the defendants. The defendants demurred generally and the case was reserved for the advice of this court.

ELLSWORTH, J. \* \* \* It is obvious that the present is not the proper form of redress to be pursued, even for civil purposes, unless we are prepared to break down long established principles of law. No such private suit will lie against the defendants, nor even a bill in equity without more parties are brought in and the allegation of certain further facts.

The general rule of law is, that an action at law must be brought by the person having the title or right to the thing demanded, or to the damages which are sought to be recovered for the injury. Hence the Woodbury Bank should have brought this suit. It is *its* property which has been misappropriated and lost, and the damages to be recovered belong to it—to be sure, in trust for bill-holders, depositors and other creditors, if any there be, and finally for the stockholders, but for all of them and not for some of them exclusively. The *bank* then must sue. It may compromise, and settle, or release the defendants on terms mutually satisfactory, which the stockholders can not do, and should they do it, it would be no bar to a suit afterwards brought by the bank. In this respect the defendants are liable to the bank as any other agents or persons would be for robbing or defrauding it or in any way injuring the corporate property. Now, to permit the plaintiff to recover for himself, as he does if he recovers at all, to the extent of the loss which he suffers in his stock, will be the means of giving him a preference to which he is not entitled. The defendants can be sued only once, and not separately by every one who is indirectly injured by their wrongful acts. Coke, Lit., 56a. Stetson v. Faxon, 19 Pick. 155.

Besides, *the directors of the bank are the agents of the bank. The bank is the only principal, and there is no such trust for, or relation to a stockholder as has been claimed by the plaintiff. The entire duty of the directors, growing out of their agency, is owed to the bank, which, under the charter, is the sole representative of the stockholders, and the legal protector and defender of their property. Nor is any other protector or defender necessary, until the bank shall neglect its duty in refusing to call the directors to account; in which event, upon a case properly stated, and with proper parties before the*

court, a court of equity may grant relief, according to the existing exigency.

It is said that the first count states that a promise was made by the directors that they would be honest and faithful in their trust, and that the action is brought on that promise. We discover no such statement, nor do we perceive any essential difference in the three modes of presenting the cause of action in the three counts; but if there be a difference, and the first count states a breach of contract as the cause of action, then the declaration is bad on demurrer, for the other counts are in tort; but as we have said, in their frame and aspect the three counts are not dissimilar; each sets forth a breach of trust, and nothing besides of material importance. Suppose, however, there be a promise, it must be held to be made to and for the corporation, and not severally to and for the individual stockholders of the corporation. If for any cause the corporation is unable to bring suit, or if, through fraud and collusion, the directors refuse or neglect to bring suit in the corporate name, and will not seek redress, a ground will be laid for invoking the interposition of a court of equity. Here there is no allegation that the corporation is unable to obtain redress, or that through fraud or collusion it refuses to seek it; nor is it alleged that application has been made to the corporation or to the directors for leave to make use of the corporate name to obtain redress and that it has been refused. Had these preliminary steps been taken, it would seem quite proper, from the necessity of the case, for a court of equity to grant relief, upon an application by an individual stockholder, if the stockholder should so frame his bill as to proceed for others as well as himself, and make the corporation and the directors parties to the bill. \* \* \*

*Declaration insufficient.*

*Note.* See, 1889, *Ten Eyck v. Pontiac, etc., R. Co.*, 74 Mich. 226, 16 Am. St. Rep. 633, note 639. See, also, note to § 592, *infra*.

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**Sec. 588. Same. (b) Trustees.**

J. ALDER ELLIS ET AL. v. SAMUEL D. WARD ET AL.<sup>1</sup>

1890. IN THE SUPREME COURT OF ILLINOIS. 137 Ill. Rep. 509-533, on 518-521.

[Bill in equity brought in 1882, by Ward as receiver of the Republic Life Insurance Company against Farwell, formerly president, and Ellis, Peet, Nickerson, and other directors of that company, seeking discovery and praying for a decree against them for the alleged wrongful payment of \$23,200 to the said Farwell. Farwell

<sup>1</sup>Statement much abridged. Only the part of the opinion relating to the relation of directors to the corporation is given. Arguments omitted.

claimed that this sum, with \$42,800 more, had been received by him in payment for 1,420 shares of stock sold by him to Ellis, Peet and Nickerson in order to enable them to obtain control of the company. The evidence showed that after the 1,420 shares were delivered and \$37,600 paid therefor, an election was held, at which Ellis, Peet and Nickerson and others voted for by them were elected directors, and these three with two others were appointed a finance committee; this committee immediately afterward, June 14, 1876, voted to pay \$23,200 to Farwell, out of the fund of the company, for past services as president, when neither by-law nor resolution fixed any compensation for such service. They also voted to pay him \$5,200 for like past services as president of another company of which they had control. After such votes these two sums, \$23,200 and \$5,200, were paid to Farwell—making in all, with the \$37,600, \$66,000—the sum Farwell asked and was to receive for his stock. The evidence was conflicting as to Farwell's knowledge of this part of the transaction, but the lower court dismissed the suit as to Farwell, and granted the decree as to Ellis et al. They appealed and among other defenses relied upon the statute of limitations.]

MR. JUSTICE SHOPE. \* \* \* If the funds of the company were by them (Ellis, Peet and Nickerson) applied to the discharge of their individual indebtedness to Farwell, under the contract of March 2, 1876, there could be no question of their liability to the company, or its representative, the receiver, for the amount thus misappropriated by them. So, also, if, after obtaining control of the corporation, they wrongfully and illegally paid out the funds of the company to Farwell for past services, in violation of their duty, they would be likewise liable.

The doctrine is well settled in this court, that the law will not imply a promise on the part of a private corporation to pay its officers for the performance of their usual duties. In order that such officers may legally demand and recover for such services, or the corporation legally make allowance and payment therefor, it must appear that a by-law or resolution had been adopted authorizing and fixing such allowance before the services were rendered. *American Central R. Co. v. Miles*, 52 Ill. 174; *Merrick v. Peru Coal Co.*, 61 Ill. 472; *Rockford, Rock Island and St. Louis R. Co. v. Sage*, 65 Ill. 328; *Cheaney v. La Fayette, Bloomington and Mississippi R. Co.*, 68 Ill. 570; 87 Ill. 446; *Holder v. La Fayette, Bloomington and Mississippi R. Co.*, 71 Ill. 106; *Gridley v. La Fayette, Bloomington and Mississippi R. Co.*, 71 Ill. 200; *Illinois Linen Co. v. Hough*, 91 Ill. 63. The rule is analogous to that governing trustees generally, who, at common law, were not entitled to compensation, except as there was warrant therefor in the contract or statute under which they acted. \* \* \*

It is a principle of general application, and recognized by this court, that the assets of a corporation are, in equity, a trust fund (*St. Louis and Sandoval Coal and Mining Co. v. Sandoval Coal and Mining Co.*, 116 Ill. 170), and that the directors of a corporation are trustees, and have no power or right to use or appropriate the funds of the corpo-

ration, their *cestui que trust*, to themselves, or to waste, destroy, give away or misapply them. *Holder v. La Fayette*, Bloomington and Mississippi R. Co., 71 Ill. 106; *Cheaney v. La Fayette*, Bloomington and Mississippi R. Co., 68 Ill. 570; 1 Morawetz on Private Corp., §§ 516, 517. And it is equally well settled, that no lapse of time is a bar to a direct or express trust, as between the trustee and *cestui que trust*. *Chicago and Eastern Illinois R. Co. v. Hay*, 119 Ill. 493; *Wood on Limitation of Actions*, § 200, and cases cited in note. If the trust assumed by the directors of a corporation in respect of the corporate property under their control is to be regarded as a direct trust, as contradistinguished from simply an implied trust, then it is apparent, under the rule announced, the statute presents no bar to this proceeding by the receiver of the corporation. Ordinarily, an express trust is created by a deed or will; but there are many fiduciary relations established by law, and regulated by settled legal rules and principles, where all the elements of an express trust exist and to which the same legal principles are applicable—and such appears to be the relation established by law between directors and corporation. 2 Pomeroy's Eq., §§ 6, 1088–1090, 1094. And see, also, as respects stockholders, *Hightower v. Thornton*, 8 Ga. 486; *Payne v. Bullard*, 23 Miss. 88; *Curry v. Woodward*, 53 Ala. 371. The statute of limitations therefore presented no bar to a recovery by the receiver. \* \* \*

*Affirmed.*

*Note.* See, 1881, *Duncomb v. N. Y. H. & N. R.*, 84 N. Y. 190; 1888, *Munson v. Syracuse G. & C. R.*, 103 N. Y. 58; 1887, *Sweeney v. Grape Sugar Co.*, 30 W. Va. 443, 8 Am. St. Rep. 88; 1889, *Beach v. Miller*, 130 Ill. 162, 17 Am. St. Rep. 291, note 298; 1891, *Mullanphy Sav. Bank v. Schott*, 135 Ill. 655, 25 Am. St. Rep. 401; 1899, *Stanley v. Luse*, 36 Ore. 25, 58 Pac. Rep. 75; 1899, *Barnes v. Lynch*, 9 Okla. 158, 59 Pac. Rep. 995; 1899, *McClure v. Law*, 161 N. Y. 78, *infra*, p. 1785; 1900, *Spaulding v. N. M. T. S. Co.*, 106 Wis. 481, 81 N. W. Rep. 1064; 1900, *Center Creek Water & Ir. Co. v. Lindsay*, 21 Utah 192, 60 Pac. Rep. 559; 1901, *Bosworth v. Allen*, 168 N. Y. 157, 55 L. R. A. 751, note; 1902, *Consolidated Vinegar Works v. Brew*, — Wis. —, 88 N. W. 603. Compare, 1899, *Patterson v. Portland Smelting, etc., Works*, 85 Ore. 96, 56 Pac. Rep. 407. See, also, note to § 592, *infra*.

Sec. 589. Same. (c) Mandataries.

#### WALLACE v. LINCOLN SAVINGS BANK.<sup>1</sup>

1891. IN THE SUPREME COURT OF TENNESSEE. 89 Tenn. Rep. 630–660, on 648, 652, 659, 24 Am. St. Rep. 625, 637, 639, 643.

[Bill by shareholder and creditor on behalf of himself and all other shareholders and creditors against such directors of the bank as held the office between 1870 and 1886, the bank itself, and its trustee, under an assignment for creditors, charging that through the inattention,

<sup>1</sup>Statement much abridged. Arguments omitted. Only so much of opinion as relates to the duties of directors is given.



negligence and mismanagement of the directors, the bank had become insolvent, its capital wasted and its shares rendered worthless. They were not charged with any fraudulent collusion, or private gain, but wholly with negligence resulting in loss, by substantially abdicating their trust in failing to superintend the management, and turning over the entire control of the business to the unlimited discretion and unaided judgment of the cashier; and especially, among other things, an alleged loss of over \$20,000, said to have resulted from loans made by the cashier to himself and to a firm of which he was a member, beginning in 1873 and continuing till 1879—then amounting to over \$50,000, and then first discovered by the board of directors. There was a decree in favor of the complainant upon some charges in the bill, but a dismissal as to the loan above mentioned. Both parties appealed. One of the grounds of dismissal as to the losses arising from the loans was that the statute of limitations had run.]

LURTON, J. \* \* \* But upon another and distinct ground complainant can not recover, and that is the bar of the statute of limitations. None of these loans were made after 1879. The negligence of defendants, if any there was, occurred prior to January 1, 1880. This suit was begun in December, 1886, more than six years after the last act of negligence in this matter. The chancellor seems to have entertained the opinion that because a stockholder can alone sue in equity upon such a cause of action, that therefore this was one of that class of purely equitable actions against which the statute does not operate. But, as we have before seen, this kind of suit is, at last, but the suit of the corporation for its benefit and upon its right of action. If for any reason the corporation is estopped from suing, or its action is barred, the suit by the stockholder or creditor is likewise affected. "A suit of this character," says Mr. Morawetz, "is brought to enforce the corporate or collective rights, and not the individual rights of the shareholders. It may therefore properly be regarded as a suit brought on behalf of the corporation, and the shareholder can enforce only such claims as the corporation itself could enforce. Moreover, the essential character of a cause of action belonging to a corporation remains the same, whether the suit to enforce it be brought by the corporation or by a shareholder. Thus a legal right of action would not be treated as an equitable one, or become governed by the rules applicable to equitable cause of action, as to limitations, etc., because a shareholder has brought suit in equity to enforce it on behalf of the company." Section 271.

Directors are not express trustees. The language of Special Judge Ingersol in *Shea v. Mabry*, 1 Lea 319, that "directors are trustees," etc., is rhetorically sound, but technically inexact. It is a statement often found in opinions, but is true only to a limited extent. *They are mandataries; they are agents; they are trustees in the sense that every agent is a trustee for his principal, and bound to exercise diligence and good faith; they do not hold the legal title, and more often than otherwise are not the officers of the corporation having possession of the corporate property; they are equally interested with*

*those they represent; they more nearly represent the managing partners in a business firm than a technical trustee. At most they are implied trustees in whose favor the statutes of limitations do run.* Hughes v. Brown, 88 Tenn. 578; Spering's Appeal, 71 Pa. St. 11; Morawetz on Corporations, § 516.

An action at law lies in favor of the corporation against directors for malfeasance, misfeasance, or negligence in office, whereby loss or damage has resulted; and the limitation applicable to the suit of the corporation at law is equally applicable to the suit of the stockholder upon the corporate right of action in equity. Morawetz on Corporations, § 271; Cook on Corporation Law, § 701; Godbold v. Bank of Mobile, 11 Ala. 191; Williams v. Hillard, 38 N. J. Eq. 383; Spering's Appeal, 71 Pa. St. 11; Brickerhoff v. Bostwick, 99 N. Y. 193.

Our statutes of limitation operate upon all causes of action save suits between *cestui que trust* and express trustee under pure technical trusts cognizable only in courts of equity. Hughes v. Brown, 88 Tenn. 578.

The statutes of six and three years were relied upon by defendants, both by demurrer and plea, as applicable to complainants' entire cause of action. By section 2773 it is provided that "actions for injuries to personal or real property, actions for the detention or conversion of personal property," shall be barred unless suit is brought within three years from the accruing of the cause of action. This is not a suit for either injury to or conversion of personal property, and this section is not applicable. The last clause of section 2775 provides a limitation of six years for all actions "on contracts not otherwise provided for." The case of Bruce v. Baxter, reported in 7 Lea, at page 477, was a bill in chancery against an attorney for neglect of duty in the collection of claims in his hands, whereby they were lost. The clause we have quoted from section 2775 was held applicable to the suit. The reasoning of Judge Freeman, who delivered the opinion of the court, was that the relation of client and attorney implied a contract for the exercise of reasonable skill and diligence in doing what was undertaken, and that a failure to exercise such diligence was a breach of contract rendering the attorney liable for the loss resulting but no more. A similar ruling was made in the earlier case of Ramsay v. Temple, 3 Lea 252, it being a suit against an attorney for negligence in failing to sue out an execution. Those cases are controlling in this. The relation of a director to a corporation implies a contract that he will use ordinary diligence in the discharge of the duties he undertakes by accepting the office. For a breach of this duty an action lies, which is barred unless begun within six years from the time right of action accrued. There has been no fraudulent concealment of the cause of action by defendants, and the remedy of the corporation for any negligence in the matter of the loans to Hampton, or Hampton & Carloss, is barred. \* \* \*

(As to other points of the case, directors' duties are stated to be as follows:)

Directors, by assuming office, agree to give as much of their time

and attention to the duties assumed as the proper care of the interests intrusted to them may require. If they are inattentive to these duties, if they neglect to attend meetings of the board, if they turn over the management of the company to the exclusive control of their agents, thus abdicating their control, then they are guilty of gross negligence with respect to their ministerial duties; and if loss results to the corporation by breaches of trust or acts of negligence committed by those left in control, which by due care and attention on their part could have been avoided, they will be responsible to the corporation. The diligence required from them has been defined as that exercised by prudent men about their own affairs, being that degree of diligence characterized as ordinary. If a less degree of diligence is exercised, the negligence is gross, and for losses consequent he is liable.

“What constitutes a proper performance of the duties of a director,” says Mr. Morawetz, “is a question of fact which must be determined in each case in view of all the circumstances; the character of the company, the condition of its business, the usual methods of managing such companies, and all other relevant facts must be taken into consideration.” Morawetz on Corporations, § 552.

Bank directors are not expected to give their whole time and attention to the business of the company. The customary method in regard to such associations is that the active management and responsible custody is left to the cashier and other agents selected by the directors for that purpose. These are paid salaries, demanding their skill and time should be given to the duties of immediate management. As a rule, the custodian of the assets is the cashier. The duty of directors with respect to such is to supervise, direct, and control. These agents, though usually selected by the directors, are not the agents of the directors, but agents of the corporation. Mor. Corp., § 552, *et seq.*

The neglect which would render them responsible for not exercising that control and direction properly must depend upon the circumstances of each particular case. They are not insurers of their fidelity, and they are not liable for their acts on any principle of the law of agency.

“Directors,” says Mr. Morawetz, “can be held responsible for a loss resulting from wrongful acts or omissions of other directors or agents only provided the loss was a consequence of their own neglect of duty, either in failing to supervise the company’s business with attention, or in neglecting to use proper care in the appointment of such agents.” Morawetz on Corporations, § 562. \* \* \*

A director in a suit between himself and the corporation, or those suing upon the corporate right of action, is not presumed to have knowledge of all that is shown by the books of the company. The presumption of knowledge attaching to a director, which is referred to in the case of *Lane v. Bank*, 9 Heis. 437, applies only in suits between the bank and a stranger. The doctrine has never been extended to suits between the bank and its directors. Savings Bank of

Louisville v. Caperton, 87 Ky. 306; Clews v. Barden, 36 Fed. Rep. 617; In re Denham, 25 Ch. Div. 752.

The doctrine of the Lane case is carefully limited in Martin v. Webb, 110 U. S. 7. \* \* \*

*Reversed on other grounds.*

*Note.* See, 1872, Spering's Appeal, 71 Pa. St. 11, 10 Am. Rep. 684; 1891, Briggs v. Spaulding, 141 U. S. 132, 11 Sup. Ct. 924; 1892, Swentzel v. Penn. Bank, 147 Pa. St. 140; 1902, Boyd v. Mutual Fire Ins. Co., 116 Wis. 155, 61 L. R. A. 918, 96 Am. St. R. 948.

See also note to § 592, *infra*.

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**Sec. 590. Same. 3. General rules as to duties and liabilities of directors to the corporation.**

**HUGHES, DISTRICT JUDGE, IN TRUSTEES OF THE MUTUAL BUILDING FUND AND DOLLAR SAVINGS BANK v. BOSSIEUX ET AL., DIRECTORS, ETC.**

1880. IN THE U. S. DISTRICT COURT (VA.) 4 Hughes Rep. 387, on 397 and 413, states the liability of directors as follows:

*First.* Fraud or embezzlement committed by themselves.

*Second.* Willful misconduct or breach of trust committed for their own benefit, and not for the benefit of the stockholders.

*Third.* Acts *ultra vires*, that is to say, acts beyond the chartered powers of the corporations which they manage, and beyond the general powers conferred by law upon corporations.

*Fourth.* Gross inattention and negligence, allowing fraud or misconduct on the part of agents, officers or co-directors, which could have been prevented if they had given ordinary care and attention to their duties. And in this latter case: 1. Gross non-attendance in a director may make him guilty of the breaches of trust committed by officers and other directors. 2. That a director's saying that he had no benefit from his office but such as was merely honorary, is no excuse for his want of diligence; and 3. That when a supine negligence appeared in all the board, by which a complicated loss has happened, they are all liable.

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**Sec. 591. Same. 4. Right of corporation to all profits made by officers by virtue of their office.**

**DAVID McCLURE, AS RECEIVER OF THE LIFE UNION, APPELLANT, v. WILLIAM H. LAW, RESPONDENT.**

1899. IN THE COURT OF APPEALS OF NEW YORK. 161 N. Y. Rep. 78-82, 76 Am. St. Rep. 262.

**HAIGHT, J.** This action was brought to recover of the defendant, a former president and director of the Life Union, the sum of \$3,000, which the plaintiff claims was profits made by the defendant out of his

trust relationship with the company. The facts established by the evidence are, in substance, as follows: An agreement was entered into on the 28th day of December, 1891, between one Horace Moody, party of the first part, and Lucius O. Robertson and Lewis P. Levy, parties of the second part, by which the party of the first part undertook to deliver to the parties of the second part the absolute control and management of the Life Union Association in consideration of the sum of \$15,000. This was to be accomplished by the resignation, from time to time, of one or more directors of the corporation, and the election of the parties of the second part, or the persons they should designate, as directors. This agreement was entered into by Moody under the directions of the defendant, for whom he was acting as agent and attorney. It was modified on the 5th day of February, 1892, with reference to details in payments, etc., but not in any respect affecting the question here presented. These agreements were subsequently executed. Mr. Levy was elected a director to fill a vacancy theretofore existing, and then the defendant resigned as president and had Mr. Levy elected in his place. Subsequently, the defendant, with other directors from time to time resigned, and their places were filled by persons designated by Levy. The money was paid over to a person designated by the defendant and then was distributed among the directors, the defendant receiving \$3,000. His excuse for this proceeding was that this transfer was made for the purpose of reimbursing himself and other directors for moneys that they had theretofore invested in the purchase of promissory notes which had been issued by the corporation for the purpose of purchasing the property and assets of the Flour City Life Association of Rochester. The notes, however, were, by their terms, payable out of the expense funds, to be derived from the transfer membership of the Flour City Association, and inasmuch as the transfer was never effected, the notes were not collectible from the Life Union. (McClure v. Levy, 147 N. Y. 215.) The defendant held three of these notes of \$1,000 each, but they can not be accepted as a justification of the transaction, or be received as a defense to this action. The question is, therefore, presented, whether the defendant is bound to account for the money received from Levy for the transfer to him and his associates of the management and control of the Life Union, together with its property and effects. The learned appellate division has treated this transaction as a bribe paid to the directors of the Life Union by Levy, and reached the conclusion that the money did not belong to the corporation. We think, however, that the law does not permit the defendant to avail himself of his own wrong as a defense to this action. As president and director of the Life Union he was bound to account to that association for all moneys that came into his hands by virtue of his official acts, and he can not be permitted to shield himself from such liability under the claim that his acts were illegal and unauthorized. As an officer he had the right to resign, but the money was not paid to him for his resignation. It was paid over upon condition that he procure Levy and his friends to be elected

directors and given the control and management, together with the property and effects of the corporation. The election of directors and the transfer of the management and property of the corporation were official acts, and whatever money he received from such official acts were moneys derived by virtue of his office for which we think he should account. \* \* \*

In Cook on Corporations, section 650, it is said: "It is a well-established principle of law that a director commits a breach of trust in accepting a secret gift or secret pay from a person who is contracting or has contracted with the corporation, and that the corporation may compel the director to turn over to it all the money or property so received by him. (See, also, *Chandler v. Bacon*, 30 Fed. Rep. 538; *Rutland El. L. Co. v. Bates*, 68 Vt. 579; *Farmers' and Merchants' Bank v. Downey*, 53 Cal. 466; *Sheridan v. Sheridan El. Light Co.*, 38 Hun 396.)

*Reversed.*

*Note.* Accord, 1900, *Goodhue Farmers' Warehouse Co. v. Davis*, 81 Minn. 210, 83 N. W. 531. Compare, 1900, *Larwill v. Burke*, 19 Ohio C. C. 449. See 1903, *Gilbert v. Finch*, 173 N. Y. 455, 61 L. R. A. 807, 93 Am. St. R. 623.

**Sec. 592. 5. Right of the corporation to careful service by its officers—Degree of care due.**

**THE NORTH HULSON BUILDING AND LOAN ASSOCIATION v. CHILDS ET AL.<sup>1</sup>**

1892. IN THE SUPREME COURT OF WISCONSIN. 82 Wis. Rep. 460-487, 33 Am. St. Rep. 57.

[Action by the loan association against Childs, president, and Denniston, treasurer, and *ex officio* members of the board of directors (consisting of the officers and seven others elected by the shareholders) to recover \$28,000 alleged to have been lost by their gross neglect, mismanagement, and inattention to their duties, from their election in 1882 until 1887, and especially in usurping powers that should have been exercised by the directors—the specific losses charged arising from uncollected dues, issuing shares for too small sums, paying too much for canceled shares, canceling loans before they were fully paid. Other facts sufficiently appear in the opinion.]

PINNEY, J. 1. The corporation plaintiff has a remedy against its directors and officers for negligence, fraud, breaches of trust, or for acts done in excess of their authority, and the case against each is distinct, depending upon the evidence against him, unless two or more have joined or participated in the wrongful act, in which case all participants may be joined in the suit. And where the act is illegal or in violation of some positive law, the authorities indicate that there is no right of contribution where one only is sued and charged; and therefore it is held in many cases that it is not necessary to make all the

<sup>1</sup> Statement much abridged. Arguments and much of opinion omitted.



directors parties who have more or less joined in the act complained of. Thomp. Liab. Off. Corp., in note 352, 353, 411, and cases cited. A different rule is maintained in the modern cases in England and America, in cases where the wrongful act is the result of negligence or gross misjudgment and is not, in and of itself, illegal or a violation of some positive law, as will be shown hereafter; and there exists high authority in such cases for holding that in all cases where contribution would be allowed in equity, there those who are liable to contribute are necessary parties to a suit in equity to obtain redress for the loss which the corporation has suffered. The remedy of the corporation for the wrong done is either at law or in equity, according to the nature of the case. Hence, in every such case as the present it is important to determine at the outset whether the action shall be or is a legal or equitable one, and if the latter, whether the necessary parties are before the court to enable it to make a proper and complete determination of the controversy. This action has been treated throughout by the plaintiff and by the circuit court as a legal action, both in the demand for judgment and in the course taken at the trial, a trial by jury having been waived, and the court ruling that no evidence of liability was competent that did not equally affect both defendants; and, after judgment by the remission of damages for the periods mentioned, on the ground that for these sums the defendants were not jointly liable, though this fact was either overlooked or was not regarded in the decision of the case.

2. The complaint is not entirely definite and clear in the allegations upon which the liability of the defendants is rested, but groups together grounds, not entirely congruous, when stated in the same cause of action, as the charge against them is gross neglect, mismanagement, and inattention of the defendants "to the duties of their said offices," and they are, to some extent, at least, attempted to be charged for negligence or misconduct in their respective offices of president and treasurer, and also as members of the board of directors, the by-laws making them *ex officio* such. Some of the acts as to which negligence and misconduct are predicated lie wholly outside the scope of the duties of either one or both the president and treasurer. In the main, the *gravamen* of the case seems to be that the defendants have exceeded their respective powers as such president and treasurer in dealing with the property and property rights of the plaintiff, and have usurped the powers of the board of directors in these respects; and it is expressly charged in the 7th, 9th, 10th, 11th, 12th, 13th and 14th "causes of action" (so designated) that they did the acts complained of "without the knowledge, consent and approval of the board of directors;" and the last of these causes of action, grouping the plaintiff's losses in one aggregate sum of \$22,000, charges "that between the 1st of March, 1882, and the 1st of September, 1887, the plaintiff, through the gross neglect, mismanagement, and inattention of the defendants to the duties of their said offices, has lost in dues, interest, and charges on stocks and loans, and on loans made by defendants, and in the wrongful cancellation of

stock by the defendants, and paying thereon more than the holders thereof were entitled to receive and be paid by said corporation, and without the knowledge, consent, or authority of the board of directors of said corporation, and without the knowledge, consent or authority of the stockholders thereof, to the amount of \$22,000." The first five "causes of action" (so designated) proceed entirely upon the ground of gross neglect and mismanagement of the defendants, and there are items also in the other causes of action based on that ground. The circuit court based the finding against the defendants on the ground "of gross negligence and usurpation of authority not given them by the by-laws but reserved to the board of directors." These different allegations, thus blended in the several so-called "causes of action," which are in fact but enumerations of items of liability under what is really but one general count, require different answers and different evidence to meet them, creating difficulties of procedure which can be best dealt with and overcome in an equitable action. We think that the case made by the pleadings and proofs is not one where an adequate and proper remedy by legal action can be obtained, but the action must be treated as an equitable one; and that the circuit court erred in dealing with it on any other basis. As a recovery in a legal action, the judgment must stand or fall on the liability of the defendants as president and treasurer, for no recovery can be had at law against a minority of the board of directors for misconduct or negligence, inasmuch as they can act only when lawfully assembled, and their duties as such are devolved on them as a board, and not individually. *Franklin Insurance Co. v. Jenkins*, 3 Wend. 134; *Gaffney v. Colvill*, 6 Hill 572, 573.

3. Much argument was had upon the rule of liability of corporate officers in cases such as this, presenting for consideration some questions in respect to which a considerable difference of opinion has prevailed. The liability of officers to the corporation for damages caused by negligent or unauthorized acts rests upon the common-law rule, which renders every agent liable who violates his authority or neglects his duty to the damage of his principal. It seems to be now universally agreed that, no matter whether the act is prohibited by the charter or by-laws, the liability is on the ground of violation of authority or neglect of duty. *Thomp. Liab. Off.*, 357; *Briggs v. Spaulding*, 141 U. S. 146, 11 Sup. Ct. Rep. 924. There can be no doubt that, if the directors or officers of a company do acts clearly beyond their power, whereby loss ensues to the company, or dispose of its property or pay away its money without authority, they will be required to make good the loss out of their private estates. *Thomp. Liab. Off. Corp.*, 375; *Joint-Stock Discount Co. v. Brown*, L. R. 8 Eq. 381; *Flitcroft's Case*, L. R. 21 Ch. Div. 519; *Franklin Insurance Company v. Jenkins*, 3 Wend. 130,—and many other authorities to this effect were cited by the respondent's counsel. This is the rule where the disposition made of money or property of the corporation is one either not within the lawful power of the corporation, or, if within the power of the corporation, is not within the power or authority

of the particular officer or officers. Where the ground of liability is for nonfeasance, negligence, or misjudgment in respect to matters within the scope of the proper powers of the officer, he will be held responsible only for a failure to bring to the discharge of his duties such degree of attention, care, skill, and judgment as are ordinarily used and practiced in the discharge of such duties or employments; the degree of care, skill, and judgment depending upon the subject to which it is to be applied, the particular circumstances of the case, and the usages of business. In respect to directors, or those acting *ex officio* as such, the rule of liability has been the subject of much discussion in the recent case of *Briggs v. Spaulding*, 141 U. S. 132, 11 Sup. Ct. Rep. 924, in which, although there was a strong dissent, the rule may be regarded as settled, in the federal courts, at least, and in the courts of several of the states, as there laid down, and to the effect that directors, although often called "trustees," are not such in any technical sense, but that they are mandataries, the relation between them and the corporation being rather that of principal and agent, but under circumstances they may be treated as occupying, in consequence of the powers conferred on them, the position of trustees to *cestuis que trustent*; that the degree of care required of them depends upon the subject to which it is to be applied, and each case is to be determined upon its own circumstances; that, as they render their services gratuitously, they are not to be held to the degree of responsibility of bailees for hire, or expected to devote their whole time and attention to their duties; that they are not, in the absence of any element of positive misfeasance, and solely on the ground of passive negligence, to be held liable, unless their negligence is gross, or they are fairly subject to the imputation of a want of good faith. It is to be remembered that they have the same interests to protect and subserve as other stockholders, and self-interest naturally prompts them to look after their own, and the degree of care they are bound to exercise is that which ordinarily prudent and diligent men would exercise under similar circumstances in respect to a like gratuitous employment, regard being had to the usages of business and the circumstances of each particular case; that they are not liable, in the absence of fraud or intentional breach of trust, for negligence, mistakes of judgment and bad management in making investments on doubtful or insufficient security. Where they have not profited personally by their bad management, or appropriated any of the property of the corporation to their own use, courts of equity treat them with indulgence. Were a more rigid rule to be applied, it would be difficult to get men of character and pecuniary responsibility to fill such positions. *Thomp. Liab. Off. Corp.* 357; *Beach Corp.*, § 249. These views are sustained in *Briggs v. Spaulding*, 141 U. S. 130; *Spering's Appeal*, 71 Pa. St. 11; *Citizens' B., L. & S. Assn. v. Coriell*, 34 N. J. Eq. 383, 392; *Swentzel v. Bank* (Pa. Sup.), 23 Atl. Rep. 413; *In re Forest of Dean Coal Min. Co.*, L. R. 10 Ch. Div. 450; *Ackerman v. Halsey*, 37 N. J. Eq. 363; *Hun v. Cary*, 82 N. Y. 65; *In re Denham*, L. R. 25 Ch.

Div. 752; Watt's Appeal, 78 Pa. St. 391. These views are applicable, we think, to the case of all officers serving and acting within the scope of their authority gratuitously, or practically so. The rule of liability in case of service for reward is well understood, and need not be repeated. It has been thought best to indicate the rules we think applicable to the liability of directors and other officers of corporations, as these questions were fully discussed at the argument, and in view of the probable importance of these questions in the future disposition of this cause.

The finding of the circuit court that no directors' meetings were held within the period mentioned, and that the business of the corporation, consisting of issuing stock, making loans, accepting prepayment of loans, and in fact all the business of the corporation, was transacted without any direction of the board of directors by the defendants and Harvey, the secretary, since deceased, is we think, sustained by the evidence, although stoutly denied by the defendants. There is not only no record of any such meetings, but those who are said to have been directors during the period all deny attending any such meetings or transacting any such business, and the defendants themselves are wholly unable to name a single director who was present at any such meeting. While the absence of a record of proceedings, due to the negligence of the secretary, would not defeat the action of the directors, we are satisfied no such meetings were held, and that the alleged want of authority in respect to many matters transacted by the defendants, or one of them, and Harvey, was not supplied at any of the stockholders' meetings, and, unless ratified subsequently, they were without requisite authority. During a period of about five years the regularly chosen directors of the corporation wholly abdicated their functions as such, and gave no attention whatever to their duties, and left everything connected with the affairs of the corporation to the management of the president, secretary, and treasurer, by virtue of their several offices, and beyond this, to take their own unheeded course. At the annual meetings of stockholders, officers and directors were regularly elected, and reports were made by the secretary and treasurer, but the directors elected utterly neglected their duties as before. The death of Harvey caused investigation, when the entire absence of proper entries on the ledger and record during all this period was discovered, as well as the fact that there was a shortage in the funds of the corporation. The defendants during all this time had proceeded to discharge the duties of their respective offices, and looked after and conducted the affairs of the corporation in connection with Harvey, the secretary, in entire good faith, not deriving any improper personal gain or profit, and without improperly appropriating to themselves any of its property or funds. They may have made mistakes and misjudged as to their powers and duties. They were not guilty of intentional wrong. The defendant Denniston, the treasurer, whose functions were purely ministerial, and extended only to receiving the moneys of the plaintiff and paying them out, and to the safe-keeping of its securities, and keeping a correct account, has accounted for and paid over every cent he

received, and yet he was charged by the circuit court with losses of the corporation, by the judgment in this case, to the amount of over \$21,000. We are unable to see how the defendants are to be thus charged as *ex officio* members of the board. They were not technically directors, and neither of them had it in his power to call a meeting of the board. They could act as *ex officio* members only at a meeting regularly convened, and no meetings were held. Directors can not act in any other manner. Cook Corp., § 592, and cases in note. This is so well settled that citations of authority would be superfluous. Stated monthly meetings of the board were required to be held on the next Tuesday after the monthly stockholders' meetings, but the directors came not. Special meetings might be called on the written request of two directors, but no such request appears to have been made, and none are willing to own, now that misfortune has overtaken the company, that he ever acted as a director during the period in question. All have been eager to take the benefits, whatever they were, of the management of the defendants, and accept their share of the money disbursed in paying off the first series of stock at a figure amounting to nearly \$8,000 more than was due on it, as it is now claimed. None but the president, treasurer and secretary appear to have been willing to give the affairs of the corporation any particular attention. And at least five of the directors are understood to have received, and still hold, their shares of this amount, and now all appear to be demanding that these defendants shall put back that amount of money from their own funds into the treasury of the plaintiff to make good the alleged loss on this and other accounts, arising out of their attempt to manage the affairs of the plaintiff without the aid or authority of the board of directors. Such a claim, when well founded in law, ought to be established by entirely satisfactory evidence. Regarding the case now presented by the record as one where a recovery must depend upon the liability of the defendants disconnected with their *ex officio* membership of the board, it is plain that Childs and Denniston, in their respective capacities as president and treasurer, are not responsible for the nonfeasance, negligence, or misfeasance of Harvey as secretary; nor is either of these liable for the nonfeasance, negligence, or misfeasance of the other in his official relations to the plaintiff. Their liability is several and separate. They can not be held jointly liable for any act in excess of the authority of either, or both of them, without proof of joint participation, to be proved in each instance, and not presumed; and here we have neither finding nor proof of improper combination or intentional wrong. If Childs and Harvey, as president and secretary, exceeded their powers in any given instance to the loss or damage of the plaintiff, Denniston is not chargeable with it, without proof that he intermeddled with it and in excess of his authority. If Denniston and Harvey, as treasurer and secretary, exceeded their powers in any case to the loss or damage of the plaintiff, Childs is not liable without proof that he intermeddled or participated in the wrong. While these rules are obviously correct, and so clearly so



that citation of authority is not needed to vindicate them, in view of the finding and the evidence upon which it was based we have felt it proper to state them at length, and with some particularity, as bearing upon the correctness of the judgment of the circuit court. \* \* \*

*Reversed.*

**Note. Care required of officers:** The cases are not in entire accord as to the degree of care required of corporate officers, and especially of directors. It would seem that in case of all officers who receive compensation for their services they should exercise ordinary care, prudence, and intelligence in serving the corporation, and would be liable for damages resulting from a failure to reach such a standard. In the case of directors and officers who do not generally receive compensation one line of authorities states the rule that they are liable only for fraud or gross negligence, *i. e.*, only for failing to exercise a slight degree of care (1872, *Spering's Appeal*, 71 Pa. St. 11, 10 Am. Rep. 684; 1892, *Swentzel v. Pennsylvania Bank*, 147 Pa. St. 140; 1899, *Lagunas Nitrate Co. v. Laguna Nitrate Syndicate*, 68 L. J. Ch. 699, 81 L. T. Rep. (N. S.) 334; 1900, *Killen v. State Bank*, 106 Wis. 546, 82 N. W. Rep. 536); another, and perhaps the best, line of authorities states the rule that such officers must exercise ordinary care, skill, and diligence, and must answer for ordinary neglect, *i. e.*, the omission of that care which every man of common prudence and discretion takes of his own concerns (1868, *Bank v. Hill*, 56 Maine 385, 96 Am. Dec. 470; 1878, *Shea v. Mabry*, 1 Lea (Tenn.) 319; 1880, *Vance v. Phoenix Ins. Co.*, 4 Lea (Tenn.) 385; 1889, *Marshall v. Farmers'*, etc., Bank, 85 Va. 676, 17 Am. St. Rep. 84; 1898, *San Pedro L. Co. v. Reynolds*, 121 Cal. 74; 1899, *Warren v. Robinson*, 19 Utah 289, 75 Am. St. Rep. 734, note 753). They are not, however, liable for errors of judgment, mistakes of fact, or of law, when they act in good faith, and with proper care (1880, *Vance v. Phoenix Ins. Co.*, 4 Lea (Tenn.) 385; 1881, *Citizens' Building, L. & S. Assn. v. Coriell*, 34 N. J. Eq. 383; 1898, *Seymour v. Spring Forest Assn.*, 157 N. Y. 697; 1900, *Wilson v. Stevens*, 129 Ala. 630, 87 Am. St. R. 86; 1903, *New Haven Trust Co. v. Doherty*, 75 Conn. 555, 96 Am. St. R. 239, 54 Atl. 209.

On the general subject of the degree of care required, see the following:

**Note**, 17 Am. St. Rep. 95-101; 1832, *Robinson v. Smith*, 3 Paige Ch. (N. Y.) 222, 24 Am. Dec. 212; 1850, *Hodges v. N. E. Screw Co.*, 1 R. I. 312, 53 Am. Dec. 624, note 639; 1855, *Smith v. Poor*, 40 Maine 415, 63 Am. Dec. 672; 1868, *Bank v. Hill*, 56 Maine 385, 96 Am. Dec. 470; 1872, *Spering's Appeal*, 71 Pa. St. 11, 10 Am. Rep. 684; 1878, *Shea v. Mabry*, 1 Lea (Tenn.) 319; 1880, *Vance v. Phoenix Ins. Co.*, 4 Lea (Tenn.) 385; 1881, *Citizens' Building, L. & S. Assn. v. Coriell*, 34 N. J. Eq. 383; 1889, *Marshall v. Farmers'*, etc., Bank, 85 Va. 676, 17 Am. St. Rep. 84, note 94; 1889, *Ten Eyck v. Pontiac*, etc., R., 74 Mich. 226, 16 Am. St. Rep. 633, note 638; 1891, *Briggs v. Spaulding*, 141 U. S. 132, 11 Sup. Ct. 924; 1891, *Wallace v. Lincoln Sav. Bank*, 89 Tenn. 630, 24 Am. St. Rep. 625; 1892, *Swentzel v. Pennsylvania Bank*, 147 Pa. St. 140; 1893, *Hoffman v. Reichert*, 147 Ill. 274, 37 Am. St. Rep. 219; 1898, *San Pedro Lumber Co. v. Reynolds*, 121 Cal. 74; 1898, *McIntyre v. Ajax Min. Co.*, 17 Utah 213, 53 Pac. Rep. 1124; 1898, *Fougeray v. Laurel S. L. Co.*, 57 N. J. Eq. 318, 41 Atl. Rep. 694; 1898, *Seymour v. Spring Forest Assn.*, 157 N. Y. 697; 1899, *Lagunas Nitrate Co. v. Lagunas Nitrate Syndicate*, 68 L. J. Ch. 699, 81 L. T. R. (N. S.) 334; 1899, *Wineburgh v. U. S. Steam, etc., Ry. Co.*, 173 Mass. 60, 73 Am. St. Rep. 261; 1899, *Harding v. American Glucose Co.*, 182 Ill. 551, 74 Am. St. Rep. 189; 1899, *Warren v. Robinson*, 19 Utah 289, 75 Am. St. Rep. 734, note 753; 1900, *Killen v. State Bank*, 106 Wis. 546, 82 N. W. Rep. 536; 1900, *Center Creek Water & I. Co. v. Lindsay*, 21 Utah 192, 60 Pac. Rep. 559; 1901, *Bosworth v. Allen*, 168 N. Y. 157, 55 L. R. A. 751, note; 1902, *Consol. Vinegar Works v. Brew*, — Wis. —, 88 N. W. 603.

One who receives payment of the individual obligation of a corporate officer out of the corporate funds is liable to the corporation for such misappropriation: 1900, *Rochester & Charlotte Tp. Co. v. Paviour*, 164 N. Y. 281, 52 L. R. A. 790, note.



Sec. 593. Same. 6. Right of corporation to remove officers.

IN THE MATTER OF THE ELECTION OF DIRECTORS AND OF  
CERTAIN OFFICERS OF THE A. A. GRIFFING IRON COMPANY.<sup>1</sup>

1898. IN THE SUPREME COURT OF NEW JERSEY. 63 N. J. Law  
Rep. 168-176.

[The iron company was organized in 1881, under the general corporation law of 1875. The by-laws provided for a board of five directors, to be elected by ballot at an annual meeting in May, and to hold office for one year and until their successors should be elected; they were to elect one of their number president, were also to elect a treasurer, and were authorized to fill all vacancies in the board or offices; to call special meetings of shareholders, and amend the by-laws. In November, 1898, a meeting of shareholders was called, by notice given, "to amend the by-laws, by increasing the board to nine directors, to be elected at the annual meeting or at any special meeting; to allow the board to remove any officer of the company at any meeting; to fill all vacancies; and to elect four new directors." At this meeting all the 3,000 shares of stock were represented, and by a vote of 1,566 to 1,434, the by-laws were amended in accordance with the notice, and under protest of some of the shareholders four new directors were elected, receiving the vote of 1,566 shares, the other shares not being voted. A recess was then taken and a directors' meeting, in accordance with special notice formerly given, was held, participated in by one old, and the four new directors, and at which the president and treasurer were removed, and new ones elected. The other directors refused to participate. The stockholders reconvened, and by the same vote of 1,566 shares ratified the action of the directors. The removed officers challenge these acts.]

COLLINS, J. The organic law of the A. A. Griffing Iron Company subjected that corporation to the control of the legislature. Sections 14, 35. Therefore, we are now to look to the revision of 1896 of the corporation act for its regulation. Section 1 of that statute enacts that every corporation shall have power to make by-laws fixing and altering the number of directors and providing for the management of its property and the regulation and government of its affairs. Section 2 enacts that the power to make and alter by-laws shall be in the stockholders. It is clear, therefore, that the amendment of November 23, 1898, increasing the number of directors was legal. That the stockholders had delegated to the directors power to amend the by-laws did not curtail their own power to amend them, and of course the later statute removed all possible restriction on such power. The protest read at the stockholders' meeting was, therefore, unavailing in this regard. Insufficiency of notice was alleged, but no defect was pointed out or has been proved. As every share of stock was represented and voted on at the meeting, no irregularity should be considered. *Handley v. Stutz*, 139 U. S. 417. The

<sup>1</sup>Statement abridged. Arguments and part of opinion omitted.

amendments must stand. It is argued that the increase of directors should not be held to have had immediate effect; that, under the provisions of section 12 of the statute, directors must be chosen for at least a year, and the argument is not only that the individual directors, but that the board as constituted at the time of election, hold for a year, not subject to change in the composition of the board. It is not denied that, where the by-laws permit special meetings, there may be an alteration in the number of directors, at any such meeting, but it is claimed that such alteration becomes effectual only at the next annual election. We are referred to numerous decisions that, in the absence of fraud or abuse of trust, stockholders must submit to the control of a corporation by its directors during their term of office. These decisions all relate to collateral attack. They have no reference to direct action of the stockholders taken by legitimate and orderly methods. The right to take such action is inherent, though generally declared and directed by statute. *Thomp. on Corp.*, § 3972. It would be preposterous to leave the real owners of the corporate property at the mercy of their agents, and the law has not done so. Our statute authorizes action by the stockholders under by-laws subject to alteration. Special meetings of the stockholders may be held under the by-laws, or, in case of necessity, under the statute. Sections 1, 2, 17, 46. If the by-laws so warrant directors may even be removed during their term. In *Imperial Hydropathic Hotel Co. v. Hampson*, 23 Ch. D. 1, it was held that without such warrant in the articles of association the directors of a joint stock company could not be removed except for cause; but Sir George Jessel, the learned master of the rolls, said that under a clause in the articles of association, authorizing amendments, it was competent for the stockholders to pass a clause enabling them to remove the directors and then act upon it. From the time of the adoption of the amendments, therefore, the stockholders were entitled to have nine directors in the board. How should the four new places have been filled pending the next annual election? Counsel for these applicants submit and cite authority that newly-created offices are "vacant;" and they contend that under the statute and the by-laws of the company the power to fill vacancies is in the directors. The provision of the statute is in section 15, which reads as follows:

"Any vacancy occurring *among the directors*, or in office of president, secretary or treasurer, by death, resignation, removal or otherwise, shall be filled in the manner provided for in the by-laws; in the absence of such provision such vacancies shall be filled by the board of directors." This language is inappropriate to a directorship newly created. The filling up of a board whose membership is enlarged seems to be left to the creating body, that is, the stockholders. In the absence of express provision there is implied power in the stockholders to do everything necessary to effectuate the corporate functions. *Thomp. on Corp.*, §§ 5641, 5642. The by-law of this company above cited is based on the statute and is even more inap-

propriate to a newly-created directorship, for the reference to an "unexpired term" presupposes a previous incumbent. We think it clear that under the amended by-laws it became the right and duty of the stockholders to elect the additional directors, and that they could do so at a special meeting called for that purpose. \* \* \*

(As to the election of the new president and treasurer the opinion proceeds:)

Its validity, of course, can be questioned only if there was invalidity in the removal of the former incumbents—for there can be no doubt of the power of the directors to fill vacancies caused by removal. The statute recognizes a power of removal (section 15), and such power is indeed inherent. If there be a fixed term of office removal must be for cause, but otherwise, unless limited by statute or by-law, the power to remove ministerial officers is absolute, in the body that elects, subject only to a right of action if there be a breach of contract of employment. *Thomp. on Corp.*, §§ 804, 805, 820. The president of a corporation has no securer tenure than any other ministerial officer. *Thomp. on Corp.*, § 4611. Our statute (section 13) simply provides that every corporation organized thereunder shall have a president, secretary and treasurer, who shall be chosen either by the directors or stockholders as the by-laws may direct, and shall hold their offices until others are chosen and qualified in their stead. The by-laws of the Griffing Company directed that the directors should choose these officers, but fixed no term of office, and at the meeting of November 23d were amended so as to give express power of removal. Such an amendment has been judicially upheld in this state. *Weinburgh v. Union, etc., Advertising Co.*, 10 Dick. Ch. Rep. 640. The stockholders ratified the removal made under this authority.

The attempt of the directors, in May, 1898, to fix a term of one year for the president and treasurer was certainly ineffectual to create any franchise. It was probably ineffectual as a contract, but, if not, the remedy for a breach is by an action for damages.

The application to set aside these elections is denied, with costs.

Compare, 1758, *Rex v. Richardson*, 1 Burrows 517; 1882, *Imperial Hydro-pathic Hotel Co. v. Hampson*, L. R. 23 Ch. D. 1; 1899, *Mobile, J. & K. C. R. Co. v. Owen*, 121 Ala. 505, 25 So. Rep. 612; 1899, *Stanley v. Luse*, 36 Ore. 25, 58 Pac. Rep. 75. The right to remove officers by those who elect or appoint them is now frequently provided for in articles of incorporation or in the by-laws. This is especially true in the large corporations recently formed under New Jersey laws.

*Resignation of officers*, see note 95 Am. St. R. 578.

## ARTICLE II. RIGHTS OF OFFICERS.

**Sec. 594.** 1. To manage the ordinary business of the corporation.

See *Metropolitan El. R. Co. v. Manhattan El. R. Co.*, 11 Daly (N. Y.) 373, *supra*, p. 694; *National State Bank v. Vigo Co. Nat'l Bk.*, 141 Ind. 352, 50 Am. St. Rep. 330, *supra*, p. 703.

*Note.* See, 1840, *Burrill v. Nahant Bank*, 2 Met. 163; 35 Am. Dec. 395; 1886, *Hutchinson v. Green*, 91 Mo. 367; 1889, *Beveridge v. N. Y. El. R.*, 112 N. Y. 1; 1897, *Sternberg v. Wolff*, 56 N. J. Eq. 389, 67 Am. St. Rep. 494.

See also, note 64 Am. Dec. 485, *et seq.*

## Sec. 595. Same.

HENRY WALLACE v. THE PIERCE-WALLACE PUBLISHING COMPANY AND J. M. PIERCE, APPELLANTS.<sup>1</sup>

1897. IN THE SUPREME COURT OF IOWA. 101 Iowa Rep. 313—333, 63 Am. St. Rep. 389.

[Suit by Wallace against the publishing company and Pierce to have a receiver appointed. Wallace was the owner of half the stock, and was secretary and treasurer. Pierce owned the other half of the stock and was president and business manager, and they together were the only directors. The company published two papers, one in Wisconsin and one in Missouri; it also owned a majority—118 shares—of stock in Homestead Company, another publishing company, of which Wallace had been editorial manager. Bitter dissension had arisen between Pierce and Wallace, which it was alleged made it impracticable and impossible to transact business with each other, that the business could not be carried on, and that the objects of the corporation were completely frustrated. Much, if not all, of the unadjusted difficulties related to the management and control of the Homestead Company. The lower court so found, and appointed a receiver to take charge of the 118 shares of stock in this company, but refused a receiver as to the other property of the Pierce-Wallace Company. Defendants appealed.]

DEEMER, J. \* \* \* With reference to the Homestead Company, we find there are decided differences between the members of the company, which are, apparently, irreconcilable; but they relate to matters *intra vires*, and, except as hereafter noted, do not have reference to the Pierce-Wallace Company. These disputes are quite largely, if not wholly, related to the editorial management of the newspaper published by the Homestead Company; Wallace insisting that he should control the utterances of that department, while Pierce and the other stockholders and directors were asserting the right of supervision, and, to a certain extent, at least, control of the editorial columns. The breach caused by this difference widened until it led to the deposition of plaintiff, by the regular vote of the directors of the corporation, from the editorial management of the paper. Now, without going into the merits of this unfortunate controversy, and without indicating our views as to who is at fault, we simply say, that if it be conceded that the managers and directors of the Homestead Company were at fault, it would give the plaintiff no right to the appointment of the receiver. The Homestead Company is not a party to this suit. It is an independent corporation, composed of different stockholders from those who own the stock in the Pierce-Wallace Company, and is managed by other officers. Again, no actionable fraud is charged against the officers of the Homestead Company. Plaintiff was deposed by a regular majority vote, and as a minority

<sup>1</sup>Statement abridged. Part of opinion omitted.

stockholder or officer he has no cause for complaint. It is a general rule that a minority can not dictate the policy of the corporation, and no interference with its management in their behalf can be justified, unless it be absolutely necessary to the attainment of justice. *Peatman v. Power Co.*, 100 Iowa 245 (69 N. W. Rep. 541). But we have already said too much as to the power to appoint a receiver for the Homestead Company, for such relief is not asked, and the receiver was not granted in a suit against it. The appointment was made with directions to the receiver to take charge of a part of the property of the Pierce-Wallace Company, to wit, the stock owned by it in the Homestead Company; and the part of this opinion referring to this last-named corporation is designed to make plain the difference which exists in these two bodies, and to show, if we can, that a dispute as to the management of the Homestead Company will not of itself authorize the appointment of a receiver for the other corporation. We take it from the record that the lower court concluded that there were such differences between Pierce and Wallace as to the management of the Homestead Company that they could not act together in matters relating to the Pierce-Wallace Company, and could not properly represent the latter corporation in the meetings of the Homestead Company, and it seems that the receiver was appointed in order that it might be represented at the meetings of the stockholders of the Homestead corporation. It further appears that the court below did not think there were such differences as would hinder the Pierce-Wallace corporation in the exercise of its functions, except in relation to the Homestead stock, for he denied the receivership as to all the property save this stock, and we may say, in justification of the court's refusal, that we think it was right in so doing. Plaintiff has not been denied any right in this corporation. He is still at liberty to handle the funds and to perform his duties as a stockholder, director and officer. What have we then as to the management of the stock in the Homestead Company?

It appears, that after Wallace's deposition as editor of the Homestead paper, he demanded a meeting of the board of directors. Pierce called the meeting, but Wallace was out of town. It was said that Pierce did not know of his absence, but this is immaterial, for the reason that a second meeting was called shortly afterward, when Wallace was in the city, and this he refused to attend. As soon as the meeting was called Pierce drew up a resolution, which gave to each of the parties a proxy to vote one-half of the Homestead Company stock at the meeting of that corporation. This resolution was submitted to Wallace in advance of the meeting, as indicating Pierce's views; and it seems that Pierce was anxious that all matters with reference to the action of this corporation should be agreed upon, to avoid any possibility of difficulty. Now, it seems to be held by some of the English courts that a receiver will be appointed where there is such a dispute among the members of a governing body as prevents the affairs being carried on properly. See *Featherstone v. Cooke*, L. R. 16 Eq. 298; 2 Cook, Stock, Stockh. and Corp. Law,



§ 684; Morawetz, Priv. Corp., §§ 284, 285. Mr. Cook says, however, the court will not interfere unless the corporation is in a condition in which there is no proper governing body, or there are such dissensions in the governing body, as that it is impossible to carry on the business with advantage to the parties interested. "In such a case the court will interfere, but only for a limited time, and to as small extent as possible." There are other authorities holding to a contrary doctrine. *American Loan and Trust Company v. Toledo, C. & S. R. Co.*, 29 Fed. Rep. 416; *Coal Co. v. Hooper* (Ala.), 17 So. Rep. 118; *Einstein v. Rosenfeld*, 38 N. J. Eq. 309. And it is manifest that courts are loth to appoint a receiver for the mere purpose of carrying on the business of a corporation which is being conducted by its proper officers, although not to the profit or satisfaction of its stockholders, for the reason, as said by Judge Thompson, in his work on Corporations, at section 6834, "that the sovereign does not furnish public agencies for the carrying on of private enterprises." But, whatever may be the true rule with reference to this matter, it appears that the Pierce-Wallace Company is being managed by the officers selected for that purpose, just as it was before plaintiff was deposed, except that he has voluntarily refused to attend its meetings, or to participate in the management of its business. There has been no such disagreement between the officers of this corporation, with reference to its affairs, as to render it impossible for it to carry on the business for which it was organized. The record shows but one meeting of the directors after plaintiff's deposition as editor of the Homestead, and this he refused to attend. Not as we understand it, because of any disagreement between the directors or stockholders as to the management of this corporation, but because of the effect it might have upon the affairs of the Homestead Company. Evidence is abundant to the effect that all essential differences grew out of difficulties which arose with reference to the management of the Homestead; and that these litigants are not at variance with reference to the management of the Pierce-Wallace Company. Plaintiff, as we believe, failed to attend the meetings of the latter corporation simply because he did not wish to have the stock held by it in the Homestead Company represented at the meeting of this last-named concern, and would not agree to the appointment of proxies, as suggested by Pierce, solely because of the effect it might have upon the Homestead difficulty. \* \* \*

The relief asked is, in effect, the dissolution of the corporation, or if this be not the prayer, it is that the management of the corporation be taken out of the hands of the officers who have been conducting its business and placed in the hands of an officer of the court for some indefinite period. It has already been seen that this is rarely, if ever, done; and, if such practice should be approved in this court, it is well to inquire, how long should the receivership be continued? There are but two stockholders in this corporation, plaintiff Wallace and defendant Pierce. Now, a court of equity has no power to make them agree; and, if their differences are such as that it is impossible for



them to carry on their business, it is not likely that the appointment of a receiver will bring about a reconciliation. It is practically conceded that a court of equity has no power, in the absence of a statute, to dissolve a going corporation. What then must result? Either that a court must carry on this business for the interest of the stockholders until the corporation is dissolved by lapse of time, or that one of the parties should sell his stock, or such portion thereof as will give a majority to one or the other of these litigants. We have already seen from the cases cited that it is with great reluctance that any court authorizes the appointment of a receiver because of dissension in the governing bodies, and when it does "it will only interfere for a limited length of time, and to as small an extent as possible." It is not necessary to decide whether the rule announced in *Featherstone v. Cooke* is applicable in a state where the statute enumerates the causes for which a receiver may be appointed, for, if we accept it as correct doctrine, we do not think it applies to the facts of this case. It may be unfortunate that there is no remedy other than a sale of his stock by one or the other of the stockholders, but, if this be the case, it is a situation into which the parties voluntarily placed themselves; and, so long as no actual legal wrong is committed by either, they must be content with their condition. Our conclusions find support in the following, among other authorities: *Hinkley v. Blethen*, 78 Me. 221 (3 Atl. Rep. 655); *Pond v. Railroad Co.*, 12 Blatchf. 280, Fed. Case No. 11265; *State v. Ross* (Mo. Sup.), 25 S. W. Rep. 947; *Loomis v. McKenzie*, 31 Iowa 425; *People v. Weigley* (Ill. Sup.), 40 N. E. Rep. 300; *Strong v. McCogg* (Wis.), 13 N. W. Rep. 895; *Hinckley v. Pfister* (Wis.), 53 N. W. Rep. 21; *French Bank Case*, 53 Cal. 495; *Republican Mountain Silver Mines v. Brown*, 7 C. C. A. 412 (58 Fed. Rep. 644); *Spelling, Priv. Corp.*, § 851; *Jones v. Bank*, 10 Colo. 464 (17 Pac. Rep. 272). The District court was in error in appointing the receiver and its order is reversed.

*Note.* See note, § 588, *supra*.

**Sec. 596. Same. 2. Right to deal with the corporation. Theories:**

(a) Dealings are not necessarily void.

#### TWIN-LICK OIL COMPANY v. MARBURY.<sup>1</sup>

1875. IN THE SUPREME COURT OF THE UNITED STATES. 91 U. S. Rep. 587-594.

[Suit by the company to have the defendant declared to hold certain oil land as trustee for the company, and to account to it for the income during the time he had control. In 1867 the company became much embarrassed, and borrowed of the defendant \$2,000, giving a

<sup>1</sup> Statement abridged; only part of opinion given.

note therefor, secured by deed of trust, conveying all its property, rights and franchises, to one Thomas, with power to sell upon default. Default was made and the land sold under the deed of trust, and was bought by the defendant. At the time of all these transactions the defendant was a stockholder and director of the company. It was found that the loan was made in good faith to help the company out of difficulty, and that the sale was open, fair, without fraud or any advantage taken by the defendant as director of the company. Decree was rendered for the defendant, and the company appealed.]

MR. JUSTICE MILLER. \* \* \* The first question which arises in this state of the facts is whether defendant's purchase was absolutely void.

That a director of a joint-stock corporation occupies one of those fiduciary relations where his dealings with the subject-matter of his trust or agency, and with the beneficiary or party whose interest is confided to his care, is viewed with jealousy by the courts, and may be set aside on slight grounds, is a doctrine founded on the soundest morality, and which has received the clearest recognition in this court and in others. *Koehler v. Black River Falls Iron Co.*, 2 Black 715; *Drury v. Cross*, 7 Wall. 299; *Luxemburg R. R. Co. v. Magnay*, 25 Beav. 586; *The Cumberland Co. v. Sherman*, 30 Barb. 553; 16 Md. 456. The general doctrine, however, in regard to contracts of this class is not that they are absolutely void, but that they are voidable at the election of the party whose interest has been so represented by the party claiming under it. We say this is the general rule, for there may be cases where such contracts would be void *ab initio*, as when an agent to sell buys of himself, and by his power of attorney conveys to himself that which he was authorized to sell. But, even here, acts which amount to a ratification by the principal may validate the sale.

The present case is not one of that class. While it is true that the defendant, as a director of the corporation, was bound by all those rules of conscientious fairness which courts of equity have imposed as the guides for dealing in such cases, it can not be maintained that any rule forbids one director among several from loaning money to the corporation when the money is needed, and the transaction is open and otherwise free from blame. No adjudged case has gone so far as this. Such a doctrine, while it would afford little protection to the corporation against actual fraud or oppression, would deprive it of the aid of those most interested in giving aid judiciously, and best qualified to judge of the necessity of that aid, and of the extent to which it may safely be given.

There are in such a transaction three distinct parties whose interest is affected by it, namely, the lender, the corporation and the stockholders of the corporation.

The directors are the officers or agents of the corporation, and represent the interests of that abstract legal entity, and of those who own the shares of its stock. One of the objects of creating a corporation by law is to enable it to make contracts, and these contracts may be

made with its stockholders as well as with others. In some classes of corporations, as in mutual insurance companies, the main object of the act of incorporation is to enable the company to make contracts with its stockholders, or with persons who become stockholders by the very act of making the contract of insurance. It is very true, that as a stockholder, in making a contract of any kind with the corporation of which he is a member, is in some sense dealing with a creature of which he is a part, and holds a common interest with the other stockholders, who, with him, constitute the whole of that artificial entity, he is properly held to a larger measure of candor and good faith than if he were not a stockholder. So, when the lender is a director, charged, with others, with the control and management of the affairs of the corporation, representing in this regard the aggregated interest of all the stockholders, his obligation, if he becomes a party to a contract with the company, to candor and fair dealing is increased in the precise degree that his representative character has given him power and control derived from the confidence reposed in him by the stockholders who appointed him their agent. If he should be a sole director, or one of a smaller number vested with certain powers, this obligation would be still stronger, and his acts subject to more severe scrutiny, and their validity determined by more rigid principles of morality and freedom from motives of selfishness. All this falls far short, however, of holding that no such contract can be made which will be valid, and we entertain no doubt that the defendant in this case could make a loan of money to the company, and as we have already said that the evidence shows it to have been an honest transaction for the benefit of the corporation and its shareholders, both in the rate of interest and in the security taken, we think it was valid originally, whether liable to be avoided afterwards by the company or not.

If it be conceded that the contract by which the defendant became the creditor of the company was valid, we see no principle on which the subsequent purchase under the deed of trust is not equally so. The defendant was not here both seller and buyer. A trustee was interposed who made the sale, and who had the usual powers necessary to see that the sale was fairly conducted, and who in this respect was the trustee of the corporation, and must be supposed to have been selected by it for the exercise of this power. Defendant was at liberty to bid, subject to those rules of fairness which we have already conceded to belong to his peculiar position; for, if he could not bid, he would have been deprived of the only means which his contract gave him of making his debt out of the security on which he had loaned his money. We think the sale was a fair one. The company was hopelessly involved beside the debt to defendant. The well was exhausted, to all appearance. The machinery was of little use for any other purpose, and would not pay transportation. Most of the stockholders who now promote this suit refused to pay assessments on their shares to aid the company. Nothing was left to the defendant but to buy it in, as no one would bid the amount of his debt. \* \* \*

(After holding that it was unnecessary to decide whether the circumstances would justify setting the sale aside on account of the fiduciary relation, that it could not be done here because of the delay in bringing suit, the decision below was affirmed.)

*Note.* See, generally, note 57 Am. St. Rep. 74, *et seq.*; 1871, Merrick v. Pennsylvania Coal Co., 61 Ill. 472; 1889, Beach v. Miller, 130 Ill. 162, 17 Am. St. Rep. 291, note 301; 1891, Mullanphy Savings Bank v. Schott, 135 Ill. 655, 25 Am. St. Rep. 401; 1898, Singer v. Salt Lake, etc., Mfg. Co., 17 Utah 143, 70 Am. St. Rep. 773; 1899, Patterson v. Portland Smelting, etc., Works, 35 Ore. 96, 56 Pac. Rep. 407; 1899, Porter v. Lassen L. & C. Co., 127 Cal. 261, 59 Pac. Rep. 563; 1900, Ryan v. Williams, 100 Fed. Rep. 172. See note to next case.

As to contracts between corporations having the same directors—they are generally valid unless fraud is shown—see, 1868, Goodin v. Cincinnati, etc., Co., 18 Ohio St. 169, 98 Am. Dec. 95; 1878, U. S. Rolling St. Co. v. Atlantic & G. W. R. Co., 34 Ohio St. 450, 32 Am. Rep. 380; 1883, Pearson v. Concord, etc., R. Co., 62 N. H. 537, 13 Am. St. Rep. 590; 1889, Memphis, etc., R. Co. v. Woods, 88 Ala. 630, 16 Am. St. Rep. 81; 1892, McComb v. Barcelona, etc., Assn., 134 N. Y. 598; 1895, Pauly v. Pauly, 107 Cal. 8, 48 Am. St. Rep. 98; 1896, San Diego, etc., Co. v. Pacific, etc., Co., 112 Cal. 53, 33 L. R. A. 788; 1899, Salina National Bank v. Prescott, 60 Kan. 490.

## Sec. 597. Same.

(b) Corporation can refuse to perform or may have contract set aside.

### MUNSON ET AL. v. THE SYRACUSE, GENEVA AND CORNING RAILROAD COMPANY.<sup>1</sup>

1886. IN THE COURT OF APPEALS OF NEW YORK. 103 N. Y. Rep. 58-77.

[Action by Munson and his associates to enforce specific performance by the S., G. & C. R. Company of a contract to deliver bonds in exchange of the property, franchises, etc., of the S., B. & C. R. Company, for which the plaintiffs tendered a proper conveyance. The plaintiffs were the bondholders of the S., B. & C. R. Co., which had become insolvent, and under foreclosure proceedings under the mortgage securing the bonds, had purchased all the property, rights of way, franchises, etc., of the S., B. & C. R. Co.; before this was done the plaintiffs had entered into an agreement with one Magee, whereby he had agreed to organize the S., G. & C. Co., and to purchase for it the property of the S., B. & C. Co., of the plaintiffs, and pay therefor in bonds of the new S., G. & C. Co.; Magee organized the S., G. & C. Co.; Munson, with nine others were made directors of the new company, and Munson became president. Soon after its organization the board of directors by unanimous vote resolved to assume the contract made by Magee with plaintiffs, and September 14, 1875, by Munson, its president, entered into a contract for that purpose—all parties at the time understanding that the S., G. & C. Co. intended to build its road upon the line of the former company,

<sup>1</sup> Statement much abridged. Arguments omitted. Only the part of the opinion relating to the single point is given.

which was partly graded, and for which considerable of the right of way had been obtained, and all of which were agreed to be conveyed by the plaintiffs. The S., G. & C. Co., however, afterward determined to locate and build on an entirely different route, and refused to deliver the bonds to the plaintiffs, or accept their tendered conveyance. There was no evidence of actual fraud in any of the transactions. The court below gave judgment for defendants, and plaintiffs appealed.]

ANDREWS, J. \* \* \* We are of opinion that the contract of September 14, 1875, is repugnant to the great rule of law which invalidates all contracts made by a trustee or fiduciary, in which he is personally interested, at the election of the party he represents. There is no controversy as to the facts bringing the case as to Munson within the operation of the rule. He and his associates were dealing with a corporation in which Munson was a director, in a matter where the interest of the contracting parties were or might be in conflict. The contract bound the corporation to purchase, and Munson, as one of the directors, participated in the action of the corporation in assuming the obligation, and in binding itself to pay the price primarily agreed upon between the plaintiffs and Magee. He stood in the attitude of selling as owner and purchasing as trustee. The law permits no one to act in such inconsistent relations. It does not stop to inquire whether the contract or transaction was fair or unfair. It stops the inquiry when the relation is disclosed, and sets aside the transaction or refuses to enforce it, at the instance of the party whom the fiduciary undertook to represent, without undertaking to deal with the question of abstract justice in the particular case. It prevents frauds by making them as far as may be impossible, knowing that real motives often elude the most searching inquiry, and it leaves neither to judge nor jury the right to determine upon a consideration of its advantages or disadvantages, whether a contract made under such circumstances shall stand or fall. It can make no difference in the application of the rule in this case, that Munson's associates were not themselves disabled from contracting with the corporation, or that Munson was only one of ten directors who voted in favor of the contract. The contract on its face notified Munson's associates of his relation to the corporation, and that the contract was subject to be defeated on that ground, and on the other hand a corporation, in order to defeat a contract entered into by directors in which one or more of them had a private interest, is not bound to show that the influence of the director or directors having the private interest determined the action of the board. The law can not accurately measure the influence of a trustee with his associates, nor will it enter into the inquiry, in an action by the trustee in his private capacity, to enforce the contract in the making of which he participated. The value of the rule of equity, to which we have adverted, lies to a great extent in its stubbornness and inflexibility. Its rigidity gives it one of its chief uses as a preventive or a discouraging influence, because it weakens the temptation to dishonesty or unfair dealing on the part of trustees by vitiating, without

attempt at discrimination, all transactions in which they assume the dual character of principal and representative.

The rule has been declared and enforced in a great variety of cases, but in none perhaps with more vigor and completeness, both upon principle and authority, than in the leading case of *Davoue v. Fanning* (2 Johns. Ch. 251, 252). But the case of *Aberdeen Railway Company v. Blaikie and others* (2 Eq. 1281), decided by the house of lords, is in many of its features similar to the present one. In that case it appeared that the plaintiffs were a manufacturing firm, and that one of them was also a manager of the Aberdeen Railway Company, the defendant, and the chairman of the board. At a meeting of the managers, they, by resolution, authorized their engineer to contract for iron chairs needed by the company. The agent contracted with the plaintiffs' firm. It did not appear that the member of the firm, who was also a manager and the chairman of the company, intermeddled with the dealing on either side, further than that it may be assumed he was at the meeting which authorized the engineer to procure a supply of chairs. The plaintiffs brought their suit to enforce specifically the performance of the contract, or in the alternative to recover damages for its non-performance. After a decision in their favor in the lower court the company appealed to the house of lords where the ruling was unanimously reversed on the ground that the contract was condemned by the rules of equity, as having been made between the company of which one of the plaintiffs was a manager, and a private firm of which he was a member. The opinion of Lord Chancellor Cranworth and Lord Brougham vindicate upon impregnable grounds the general rule and its application to the particular case. \* \* \*

*Affirmed.*

*Note.* See, 1881, *Duncomb v. N. Y., H. & N. R.*, 84 N. Y. 190; 1899, *Griffith v. Blackwater B. & L. Co.*, 47 W. Va. 56, 33 S. E. Rep. 125, *supra*, p. 897; 1899, *Stanley v. Luse*, 36 Ore. 25, 58 Pac. Rep. 75; 1899, *Barnes v. Lynch*, 9 Okl. 156, 59 Pac. Rep. 995; 1903, *Hodge v. U. S. Steel Corporation*, — N. J. —, 60 L. R. A. 742.

**Sec. 598. Same.** (3) Right of officer to compensation.

(a) General doctrine.

**NATIONAL LOAN AND INVESTMENT COMPANY v. ROCKLAND COMPANY.<sup>1</sup>**

1899. IN THE U. S. CIRCUIT COURT OF APPEALS, EIGHTH CIRCUIT, MINNESOTA. 94 Fed. Rep. 335-340.

[Action on a note for \$3,747.64, dated October 1, 1896, signed by the investment company, by its vice-president and secretary, payable to H. S. Jenkins, and indorsed by him to the Rockland Company.

<sup>1</sup> Statement much abridged, and only the part of the opinion relating to salary of officers given.



The defense was that the note was without consideration and void. A referee found that at the commencement of business by the investment company, soon after its incorporation, all the persons interested in it, understood and agreed with Jenkins, the president, that all officers should receive reasonable compensation for their services, and a by-law was adopted by the stockholders at the organization authorizing the board of directors to fix salaries of officers. Jenkins served as president from October 14, 1886, until after 1892. The directors in 1890 approved and allowed his claim of \$600 per year, from September 1, 1887, to September 1, 1890, and the next year a like sum; at the time these sums were allowed there was an oral agreement that they should draw 8 per cent. interest until paid. In 1893 these sums with interest due were put in the form of a note, and the note sued on was the last renewal of the note thus given for salary. At the times the claims were allowed Jenkins and two others were directors, and the claims were unanimously allowed. No fraud was charged; there were no creditors, and no complaint was ever made by anyone until suit was brought on the notes in 1897.]

SANBORN, CIRCUIT JUDGE. \* \* \* It is contended that the facts found by the referee do not warrant his conclusion of law, that the defendant in error was entitled to a judgment upon the note. The position here urged is that the note was given for back pay voted to the president of the corporation by the board of directors, of which he was a member, that this was an attempt to create a debt of the company by a mere vote of the board without any consideration, and that this act was beyond the powers of the directors and void. The directors of a corporation are trustees for its stockholders. They represent and act for the owners of its stock. Ordinarily, the employment of a servant by a corporation raises the implication of a contract to pay fair wages or a reasonable salary for the service rendered, because it is the custom to pay such compensation, and men rarely sacrifice their time and expend their labor or their money in the service of others without reward. Directors of corporations, however, usually serve without wages or salary. They are generally financially interested in the success of the corporation they represent, and their service as directors secures its reward in the benefit which it confers upon the stock which they own. In other words, the custom is to pay the ordinary employes of corporations for the services they render, but it is the custom of directors of corporations to serve gratuitously, without compensation or expectation of it. The presumption of law follows the custom. From the employment of an ordinary servant the law implies a contract to pay him. From the service of a director, the implication is that he serves gratuitously. The latter presumption prevails, in the absence of an understanding or an agreement to the contrary, when directors are discharging the duties of other offices of the corporation to which they are chosen by the directory, such as those of president, secretary, and treasurer. Moreover, as the members of boards of directors act in a fiduciary capacity, they are without the power or authority to dispose of the property of the corporation

without consideration. Consequently they may not lawfully vote back pay to an officer who has been serving the corporation voluntarily without any agreement that he shall receive any reward for the discharge of his duties. It is beyond their powers to create a debt of the corporation by their mere vote or resolution.

Some authorities have gone so far as to hold that officers of a corporation, who are also its directors, can not recover for the discharge of their duties unless their compensation is fixed by a by-law or by a resolution of the board before their services are rendered. *Gridley v. Railway Co.*, 71 Ill. 200, 203; *Kilpatrick v. Bridge Co.*, 49 Pa. St. 118, 121; *Wood v. Manufacturing Co.*, 23 Ore. 20, 25, 23 Pac. Rep. 848. The fact is, however, that, in the active and actual business transactions of the world, many officers of corporations, who are also members of their boards of directors, spend their time and their energies for years in the interest of their corporations, and greatly benefit the owners of their stock, under agreements that they shall have just, but indefinite, compensation for their services. We are unwilling to hold that such officers should be deprived of all compensation because the amounts of their salaries were not definitely fixed before they entered upon the discharge of their duties. A thoughtful and deliberate consideration of this entire question, and an extended consideration of the authorities upon it, has led to the conclusion that this is the true rule: Officers of a corporation, who are also directors, and who, without any agreement, express or implied, with the corporation or its owners, or their representatives, have voluntarily rendered their services, can recover no back pay or compensation therefor; and it is beyond the powers of the board of directors, after such services are rendered, to pay for them out of the funds of the corporation, or to create a debt of the corporation on account of them. *Jones v. Morrison*, 31 Minn. 140, 147, 16 N. W. Rep. 854; *Blue v. Bank*, 145 Ind. 518, 522, 43 N. E. Rep. 655; *Doe v. Transportation Co.*, 78 Fed. Rep. 62, 67; *Association v. Stonemetz*, 29 Pa. St. 534; *Railroad Co. v. Ketchum*, 27 Conn. 170; *Road Co. v. Branegan*, 40 Ind. 361, 364. But such officers, who have rendered their services under an agreement, either express or implied, with the corporation, its owners or representatives, that they shall receive reasonable, but indefinite, compensation therefor, may recover as much as their services are worth; and it is not beyond the powers of the board of directors to fix and pay reasonable salaries to them after they have discharged the duties of their offices. *Missouri River Co. v. Richards*, 8 Kan. 101; *Rogers v. Railway Co.*, 22 Minn. 25, 27; *Railroad Co. v. Tiernan* (Kan. Sup.), 15 Pac. Rep. 544, 553; *Stewart v. Railroad Co.*, 41 Fed. Rep. 736, 739; *Rosborough v. Canal Co.*, 22 Cal. 557, 562. \* \* \*

The note was not without consideration, and the judgment upon it was right. \* \* \*

**Note. Compensation of officers:** The general rule is that the general corporate officers,—such as directors, the president, vice-president, secretary, and treasurer,—are not entitled to any compensation for the performance of

their purely corporate duties unless there is an express promise to pay for the same, or an understanding before they are performed that they are to be paid for. See, 1865, Kilpatrick v. Penrose Ferry Bridge Co., 49 Pa. St. 118, 88 Am. Dec. 497; 1872, Rockford, etc., R. Co. v. Sage, 65 Ill. 328, 16 Am. Rep. 587; 1880, Citizens' Nat'l Bk. v. Elliott, 55 Iowa 104, 39 Am. Rep. 167; 1890, Martindale v. Wilson Cass Co., 134 Pa. St. 348, 19 Am. St. Rep. 706; 1893, Crumlish v. Central Imp. Co., 38 W. Va. 390, 45 Am. St. Rep. 872; 1899, St. L. A. & S. R. Co. v. O'Hara, 177 Ill. 525; 1899, Henry Wood's Son's Co. v. Schaefer, 173 Mass. 449, 53 N. E. Rep. 881; 1899, Fitchett v. Murphy, 26 Misc. (N. Y.) 544; 1899, Ravenswood S. & G. R. Co. v. Woodyard, 46 W. Va. 558, 33 S. E. Rep. 285. Compare, 1899, Mobile J. & K. C. R. Co. v. Owen, 121 Ala. 505, 25 So. Rep. 612, and cases following, §§ 592, 593.

But persons not stockholders may be compensated for services as officers: 1893, Crumlish v. Cent. Imp. Co., 38 W. Va. 390, 45 Am. St. Rep. 872.

And for services rendered outside of their regular corporate duties, there is an implied promise to pay what they are worth: 1873, Cheeney v. La Fayette R. Co., 68 Ill. 570, 18 Am. Rep. 584; 1878, Santa Clara Min. Assn. v. Meredith, 49 Md. 389, 33 Am. Rep. 264; 1884, New Orleans Co. v. Brown, 36 La. Ann. 138, 51 Am. Rep. 5; 1890, Wood v. Lost Lake Mfg. Co., 23 Ore. 20, 37 Am. St. Rep. 651; 1897, Reeve v. Harris, — Tenn. Ch. App. —, 50 S. W. Rep. 658; 1899, Louisville, etc., Assn. v. Hegan, — Ky. —, 49 S. W. Rep. 796; 1899, Kenner v. Whitelock, 152 Ind. 635, 53 N. E. Rep. 232; 1900, Bassett v. Fairchild, — Cal. —, 61 Pac. Rep. 791; 1900, Flynn v. Columbus Club, 21 R. I. 534, 45 Atl. Rep. 551; 1901, Taussig v. St. Louis, etc., Co., 166 Mo. 28, 89 Am. St. R. 674.

## Sec. 599. Same.

(b) Strict rule.

See Ellis v. Ward, 137 Ill. 509, *supra*, p. 1729.

*Note.* See note preceding case.

## Sec. 600. Same.

REEVE ET AL. V. HARRIS ET AL.<sup>1</sup>

1897. IN THE COURT OF CHANCERY APPEALS OF TENNESSEE. 50 S. W. Rep. 658-661.

[Bill filed to settle the affairs of a manufacturing company. One H. intervened and filed a claim for services as treasurer of the company; this was referred to a master, who reported, allowing the claim; the corporation excepted, and on a hearing the chancellor disallowed it upon the ground that no compensation was provided for by any by-law or resolution of the stockholders or directors. H. then filed a claim for services performed while treasurer outside his duties as such. This was partly allowed by the chancellor, and the corporation assigns this as error.]

NEIL, J. \* \* \* The state of the law upon this subject is correctly set forth in Beach Priv. Corp., as follows: "The authorities are not uniform upon the question of the right of executive officers of

<sup>1</sup> Statement much abridged. Only the part of the opinion relating to salaries of officers is given.

a corporation to compensation for their services. It has been held in Illinois and in Pennsylvania that a treasurer can not, in the absence of any contract agreement, recover a salary from the corporation for his services rendered to it. In Iowa, an officer of a corporation can recover payment only where there is a special contract therefor, and it is there held that no contract to pay for his services can be implied as against the corporation. So, in a lower court in New York, it was said that one is not necessarily entitled to a salary from the fact that he was chosen secretary of a corporation, and rendered services as such, especially where the facts rebut the presumption of a promise of payment. The New York case, however, was reversed in the court of last resort, where the ground was taken that, if the secretary were neither a director nor a stockholder, an agreement to compensate him for his services would be presumed from the fact of his appointment. And this is probably the general rule in respect of executive officers other than the president or vice-president of the company." Section 200. See, also, 2 Cook Stock. Stockh. and Corp. Law, § 657, and notes thereto; Kilpatrick v. Bridge Co., 49 Pa. St. 118; Gridley v. Railway Co., 71 Ill. 200; Bank v. Elliott, 55 Iowa 104, 7 N. W. 470; Crumlish's Admr. v. Improvement Co., 38 W. Va. 390, 18 S. E. 456, 45 Am. St. Rep. 872, 881-883, and authorities there cited. In the case last cited the reason of the rule is thus quoted, with approval, from Kilpatrick v. Bridge Co., *supra*: "The rule is just as applicable to presidents and treasurers and other officers as to directors. \* \* \* It is well the law is so. Corporate officers have ample opportunities to adjust and fix their compensation before they render service, and no great mischief is likely to result from compelling them to do so. But if, on the other hand, actions are to be maintained by corporate officers for services which, however faithful and valuable, were not rendered on the foot of an express contract, there would be no limitation to corporation liabilities, and stockholders would be devoured by officers." See, also, Ten Eyck v. Railroad Co. (Mich.), 3 Lawy. Rep. Ann. 378, and notes (s. c. 41 N. W. 905), and Brown v. Silver Mines (Colo. Sup.), 30 Pac. 66.

But it is also true that a corporation official rendering services to the corporation outside of the scope of his official duty, and not required thereby, may recover compensation therefor upon a promise implied from facts and circumstances, even though he be a director in the corporation. Association v. Meredith, 49 Md. 389; 1 Mor. Priv. Corp., § 508; Construction Co. v. Fitzgerald, 137 U. S. 98, 11 Sup. Ct. 36. \* \* \* (The court found that the only work H. performed outside his duties of treasurer was acting as a member of a committee to measure and report upon a stock of lumber purchased by the company, but there was no proof as to the value of these services, and, therefore, dismissed the petition of H.)

*Note.* See note, § 598; 1901, Taussig v. St. Louis, etc., R. R. Co., 166 Mo. 28, 89 Am. St. R. 674, 65 S. W. 962.

## SUBDIVISION IV. THE CORPORATION AND CREDITORS.

## Sec. 601.

See *infra*, Creditors and the corporation, p. 1808 *et seq.*; *infra*, Notice to the corporation, § 602; *supra*, Liabilities of the corporation, p. 1236 *et seq.*

## SUBDIVISION V. THE CORPORATION AND OUTSIDE PARTIES.

## Sec. 601a.

See *supra*, Rights and duties of the corporation, p. 914, *et seq.*; *supra*, Liabilities of the corporation, p. 1236, *et seq.*

## ARTICLE I. NOTICE TO THE CORPORATION.

## Sec. 602. 1. Notice to a director.

FAIRFIELD SAVINGS BANK v. ISAAC CHASE.<sup>1</sup>

1881. IN THE SUPREME JUDICIAL COURT OF MAINE. 72 Maine Rep. 226-230, 39 Am. Rep. 319.

PETERS, J. A notice to a bank director or trustee, or knowledge obtained by him, while not engaged either officially or as an agent or attorney in the business of the bank, is inoperative as a notice to the bank. If otherwise, corporations would incur the same liability for the unofficial acts of directors that partnerships do for the acts of partners, and corporate business would be subjected oftentimes to extraordinary confusion and hazards. Carry the proposition, that notice to a director is notice to the bank, to its logical sequence, and a corporation might be made responsible for all the frauds and all the negligences pertaining to its business of any and all its directors not officially employed. Any one director would have as much power as all the directors.

A single trustee or director has no power to act for the institution that creates his office, except in conjunction with others. It is the board of directors only that can act. If the board of directors or trustees makes a director or any person its officer or agent to act for it, then such officer or agent has the same power to act, within the authority delegated to him, that the board itself has. His authority is in such case the authority of the board. Notice to such officer, or agent, or attorney, who is at the time acting for the corporation in the matter in question, and within the range of his authority or supervision, is notice to the corporation. Abbott's Trial Ev. 45, and cases in note; Fulton Bank v. Canal Co., 4 Paige 127; La Farge Fire Ins. Co. v. Bell, 22 Barb. 54; National Bank v. Norton, 1 Hill (N. Y.) 578; Bank of

<sup>1</sup> Facts sufficiently stated in the opinion. Arguments omitted.

U. S. v. Davis, 2 Hill (N. Y.) 454; North River Bank v. Aymar, 3 Hill (N. Y.) 263; Ins. Co. v. Ins. Co., 10 Md. 517; Bank v. Payne, 25 Conn. 444; Farrell Foundry v. Dart, 26 Conn. 376; Smith v. South Royalton Bank, 32 Vt. 341; Washington Bank v. Lewis, 22 Pick. 24; Commercial Bank v. Cunningham, 24 Pick. 270; Housatonic Bank v. Martin, 1 Met. 294; 1 Pars. Con. \*77; Story Agen., § 140; South. Law Rev. N. S., vol. 6, p. 45; Hoover v. Wise, 91 U. S. 308.

Another question arises in the case before us. It appears that Brown's knowledge of a previous conveyance was acquired anterior to his employment by the bank, if employed by the bank at all, and not during or in the course of his employment on their account. The question is, whether a principal is bound by knowledge or notice which his agent had previous to his employment in the service of the principal.

Upon this question the authorities disagree. The negative of the question has been uniformly maintained in Pennsylvania and some other of the states. In the late case of Houseman v. The Building Association, 81 Pa. St. 256, it was said, that "notice to an agent twenty-four hours before the relation commenced is no more notice than twenty-four hours after it has ceased would be." But we think, all things considered, the safer and better rule to be that the knowledge of an agent, obtained prior to his employment as agent, will be an implied or imputed notice to the principal, under certain limitations and conditions, which are these: The knowledge must be present to the mind of the agent when acting for the principal, so fully in his mind that it could not have been at the time forgotten by him; the knowledge or notice must be of a matter so material to the transaction as to make it the agent's duty to communicate the fact to his principal; and the agent must himself have no personal interest in the matter which would lead him to conceal his knowledge from his principal, but must be at liberty to communicate it. Additional modification might be required in some cases.

These elements appearing, it seems just to say that a previous notice to an agent is present notice to the principal. The presumption that an agent will do what it is his right and duty to do, having no personal motive or interest to do the contrary, is so strong that the law does not allow it to be denied. There may be instances where the rule operates harshly; but, under the rule reversed, many frauds could be easily perpetrated. Of course, the knowledge must be that of a person who is executing some agency, and not acting merely in some ministerial capacity, as servant or clerk. For instance, if in the present case Brown had merely taken the acknowledgment of the deed to the bank, or had transcribed the deed as a clerk or copyist, such acts would not have imposed a duty to impart his knowledge to the bank. But if employed to obtain the title for the bank by a deed to be drawn by him for the purpose, that would place the transaction within the rule. Jones Mort. (2d ed.), § 587. Notice of the exist-



ence of an unrecorded mortgage upon the property to an officer employed to make an attachment, is notice to the plaintiff. *Tucker v. Tilton*, 55 N. H. 223. In the case before us, Brown, it is claimed by the defendant, was employed by the bank to make an instrument to convey a title from a person to the bank. Brown knew that such person had not the title. It would be his duty to so inform his client. He would be likely to do so. He had no motive not to do it. The law conclusively presumes that he did inform him. We think such a case comes reasonably within the rule, though it is not so marked a case as it would be if Brown had been employed by the bank to ascertain if the grantor had the title, and if he had, then to make the deed.

The general rule or principle touching this case, guarded by the cautions and conditions stated, is supported by the later English cases, although the earlier English cases went the other way, is also the law of the United States Supreme Court, and is, we think, sustained by a preponderance of opinion in the state courts where the question has been discussed. *Fuller v. Bennett*, 2 Hare 394; *Dresser v. Norwood*, 17 C. B. (N. S.) 466; *Rolland v. Hart*, L. R. 6 Ch. App. 678; *The Distilled Spirits*, 11 Wall. 356; *Hovey v. Blanchard*, 13 N. H. 145; *Hart v. The Bank*, 33 Vt. 252; *Suit v. Woodhall*, 113 Mass. 391; *National Bank v. Cushman*, 121 Mass. 490; *Anketel v. Converse*, 17 Ohio St. 11; *Hoppock v. Johnson*, 14 Wis. 328; *Lawrence v. Tucker*, 7 Maine 195; *Jones Mort.* (2d ed.), § 584, and following section and notes. Many other cases, on both sides the questions, will be found cited and reviewed in a learned article in the *Amer. Law Reg.* (Phila.) New Series, vol. 16, p. 1.

An application of this rule to the facts of this case requires the verdict to be set aside. S. S. Brown, while a trustee of the Fairfield Savings Bank, had actual knowledge that John W. Chase had deeded certain land to Isaac Chase. Knowing that fact, he as an attorney wrote and took the acknowledgment of a mortgage of the same land from John W. Chase to the bank, and the mortgage was recorded first. The question was whether the bank had knowledge of the prior deed when the mortgage was taken. The *pro forma* ruling that the knowledge of Brown was sufficient notice to the bank to overcome the legal effect of the fact that the mortgage was recorded before the deed, irrespective of the further question whether Brown was, at the time of making the mortgage, acting as an attorney in the business and employment of the bank or not, was erroneous. It is contended that the evidence shows that Brown was acting for the bank. But the fact being at least questionable, it should have been passed upon by the jury.

*Exceptions sustained.*

Appleton, C. J., Walton, Barrows, Danforth and Symonds, JJ., concurred.

*Note.* See note, 39 Am. Rep. 322. In 1893, *Bard v. Pennsylvania, etc., Ins. Co.*, 153 Pa. St. 257, 34 Am. St. Rep. 704, it is held that notice to a director is not notice to the corporation. Notice must be given to an executive officer. But notice given to the board of directors at a regular meeting is sufficient

(1840, *Bank of Pittsburgh v. Whitehead*, 10 Watts. (Pa.) 397, 36 Am. Dec. 186, note 186. See, also, note 6 So. Law Rev. 816). And a director is not charged with notice of the contents of the corporate books (1878, *In re Wincham Shipbuilding Co.*, L. R. 9 Ch. Div. 329). Notice to a single shareholder or corporator is not notice to the corporation (1893, *Mercantile Nat'l Bank v. Parsons*, 54 Minn. 56, 40 Am. St. Rep. 299); but notice to all the shareholders or members seems to be sufficient (1854, *Wilson v. McCullough*, 23 Pa. St. 440, 62 Am. Dec. 347). See, further, next case and note.

**Sec. 603. Same.** (2) Notice to an officer, when he is acting in his own behalf.

**THE MERCHANTS' NATIONAL BANK OF KANSAS CITY v. LOVITT,  
APPELLANT.<sup>1</sup>**

1893. IN THE SUPREME COURT OF MISSOURI. 114 Mo. Rep. 519—  
527, 35 Am. St. Rep. 770.

[Suit by the bank upon a note for \$2,900, executed by Lovitt, and payable to one Dickinson, and by him indorsed to the bank. The defense was a failure of consideration, the facts showing that the note had been given to Lovitt by Dickinson for fifty-five shares in the stock of a corporation about to be formed, and which Dickinson agreed to deliver to Lovitt. The corporation never was formed. Before the note was due Dickinson, who was vice-president of the bank, presented it to the bank to be discounted, and the president of the bank agreed to take the note, the figuring up of the discount being left to Dickinson, who did this, gave the slip to the discount clerk, indorsed and delivered the note to the bank, obtained credit for the amount, and then checked it out. The defendant asked the court to declare that the knowledge of Dickinson, as vice-president of the bank, was the knowledge of the bank. The court refused, and this is the error assigned.]

BLACK, P. J. \* \* \* It is a general rule that notice of a fact acquired by an agent while transacting the business of his principal is notice to the principal, and this rule applies to banking and other corporations as well as to individuals. It is the duty of the agent to communicate to the principal information thus acquired, which would affect the rights of the principal; and the presumption is that the agent has performed his duty in this behalf. If he has not, still the principal should be charged with notice of the existence of such facts thus coming to the knowledge of the agent, because he selects his own agent, and confides to him the particular business. Story on Agency, § 140. But the reason of the rule ceases when the agent acts for himself and not his principal, and the rule itself ought not to apply in such a case. Accordingly it has been held by this court that knowledge of an unrecorded deed acquired by officers of a corporation,

<sup>1</sup> Statement abridged, arguments and part of opinion omitted.

while acting for themselves and not for the corporation, will not be imputed to the corporation. *Johnston v. Shortridge*, 93 Mo. 227.

An officer of a banking corporation has a perfect right to transact his own business at the bank of which he is an officer, and in such a transaction his interest is adverse to the bank, and he represents himself and not the bank. The law is well settled that, when an officer of a corporation is dealing with it in his individual interest, the corporation is not chargeable with his uncommunicated knowledge of facts derogatory to his title to the property which is the subject of the transaction. *Taylor on Corporations* (2d ed.), § 210; 1 *Waterman on Corporations*, § 135; *Frenkel v. Hudson*, 82 Ala. 158; *Wickersham v. Zinc Co.*, 18 Kan. 481; *Barnes v. Gas Light Co.*, 27 N. J. Eq. 33; *Innerarity v. Bank*, 139 Mass. 332.

In the case last cited, the court, after speaking of the general rule that knowledge of the agent will be imputed to the principal, says: "But this principle can have no application where the director of the bank is the party himself contracting with it. In such case the position he assumes conflicts entirely with the idea that he represents the interest of the bank. \* \* \* A director offering a note, of which he is the owner, for discount, or proposing for a loan of money on collateral security alleged to be his own property, stands as a stranger to it."

Now, the facts set up to defeat a recovery here are the facts constituting the transaction between Dickinson and the defendant, in which Dickinson did not represent or profess to represent the bank, and with which the bank had nothing whatever to do. Again, Dickinson in offering the note to the bank for discount represented his own personal interest, and Clark, the president, represented the bank. In this particular transaction Dickinson occupied the position of any other customer, and not that of an officer or agent of the bank, and it must follow from the principles of law before stated that the bank is not chargeable with his knowledge of uncommunicated facts affecting his title to the note. But it is said Dickinson fixed and figured out the discount, and hence he did in point of fact represent the bank. The note bore interest at the rate of 8 per cent. per annum from date, and it appears Dickinson calculated interest at that rate from the 11th of July, the date of the transaction, to the 27th of that month, the date of the note, and deducted as discount \$10.30, but it does not appear who designated the amount of discount to be paid. The broad fact remains that the president of the bank agreed to take the note, and that the bank accepted the discount as figured up by Dickinson, and the fact, if such it was, that he may have designated the rate of discount in the first instance is wholly immaterial. He nevertheless represented his own interest in the entire transaction. The judgment is affirmed. All concur.

*Note.* The general rule is that knowledge casually obtained, or obtained by or given to an officer who is at the time engaged in a private transaction, is not notice to the corporation. 1891, *Koehler v. Dodge*, 31 Neb. 328, 28 Am. St. Rep. 518; 1891, *Lyndon Mill Co. v. Lyndon, etc.*, Inst., 63 Vt. 581, 25 Am. St. Rep. 783; 1892, *Gemmell v. Davis*, 75 Md. 546, 32 Am. St. Rep.

412; 1893, Willard v. Denise, 50 N. J. Eq. 482, 35 Am. St. Rep. 788; 1893, Casco Nat'l Bank v. Clark, 139 N. Y. 307, 36 Am. St. Rep. 705; 1893, Merchants' Nat'l Bank v. Clark, 139 N. Y. 314, 36 Am. St. Rep. 710; 1895, Kearney Bank v. Froman, 129 Mo. 427, 50 Am. St. Rep. 456; 1896, Franklin Min. Co. v. O'Brien, 22 Colo. 129, 55 Am. St. Rep. 118; 1898, Seaverns v. Presbyterian Hospital, 173 Ill. 414, 64 Am. St. Rep. 125; 1898, Dorr v. Life Ins. Co., 71 Minn. 38, 70 Am. St. Rep. 309, note 312; 1898, Surety Co. v. Pauly, 170 U. S. 133; 1898, Hart Pioneer Nurseries v. Coryell, 8 Kan. App. 496, 55 Pac. Rep. 514; 1898, Wells, Fargo & Co. Express v. Walker, 9 N. M. 170, 456, 54 Pac. Rep. 875; 1898, Red River Valley L. & I. Co. v. Smith, 7 N. Dak. 236; 1900, Brennan v. Emery-Bird-Thayer Dry Goods Co., 99 Fed. Rep. 971.

If the proper officer knows stock is pledged, this is the knowledge of the corporation. 1895, Guarantee Co. v. East R. T. Co., 96 Ga. 511, 51 Am. St. Rep. 150.

### Sec. 604. Same. (3) Notice to a servant.

#### CITY OF DENVER ET AL v. SHERRET.<sup>1</sup>

1898. IN THE UNITED STATES CIRCUIT COURT OF APPEALS, COLORADO. 88 Fed. Rep. 226-237.

[Action by Sherret against the City of Denver and the Denver Consolidated Electric Company to recover damages for injury caused by the falling of an electric light pole, alleged to be due to the negligence of both defendants; judgment was rendered for the plaintiff, and errors were assigned relating, among other things, to the charge to the jury as to what constituted notice of the condition of the pole to the electric company.]

SHIRAS, DISTRICT JUDGE. \* \* \* It is also assigned as error that the court charged the jury that if Blake, who was an employe of the company, made an examination of the pole and discovered its rotten and unsafe condition, this would be notice to the company, whether he communicated this knowledge to any officer of the company or not. Blake was called as a witness for the defendant in error, and he testified that he was in the employ of the electric company as a lamp trimmer, it being his duty to trim the lamps, report the "outs," put in carbons, and to report anything that looked bad—to report any trouble. He further testified that, some ten or fifteen days before the pole fell which injured Miss Sherret, he examined the pole with a screwdriver and found "that the screwdriver went in pretty easy, and showed that it (the pole) was pretty rotten," and that he was led to make this examination from seeing the pole "wriggling." He further testified that he notified Mr. Sheridan, a storekeeper of the company, of the fact he had discovered. Mr. Sheridan, being called as a witness, denied receiving such report or notice from Blake. Mr. McSparrin, the line foreman of the electric company, and Mr. Barker, the superintendent, both testified that it was Blake's duty to report any defects he discovered either to the foreman or the superintendent, and

<sup>1</sup> Statement abridged. Only the part of the opinion relating to notice is given.

both witnesses denied receiving any report of the defect in the pole from him. The court instructed the jury that if they found from the evidence that Blake did in fact examine the pole and discover the unsafe condition thereof at the time he stated in his testimony, this would be notice to the company, regardless of the question whether he made a report thereof to any other employe or officer of the company, and this ruling is assigned as error.

In Thompson on the Law of Corporations (volume 4, § 5195) the rule is stated to be to the effect that, in order to bind the principal, the notice must be communicated to one whose duty it is "to act for the principal upon the subject of the notice, or whose duty it is to communicate the information either to the principal or to the agent whose duty it was to act for him with regard to it." Counsel for the electric company, in the brief submitted, state their views of the rule in the following terms: "The general rule with reference to the question of notice is that notice to the agent is notice to the principal, if the agent comes to a knowledge of the facts while he is acting for the principal; but this rule is limited by the further rules that notice to the agent, to bind the principal, must be within the scope of the employment,"—and cite in support thereof the cases of *The Distilled Spirits*, 11 Wall. 356, and *Rogers v. Palmer*, 102 U. S. 263. In the former case it was said that "the general rule that a principal is bound by the knowledge of his agent is based on the principle of law that it is the agent's duty to communicate the knowledge which he has respecting the subject-matter of negotiation, and the presumption that he will perform that duty"; and in the latter case it was held that knowledge obtained by an attorney when conducting a case for a client was imputable to the latter.

As already stated, Blake testified that it was his duty to report anything wrong or any trouble he discovered about the poles or wires of the company; and none of the witnesses for the electric company deny this fact, but, on the contrary, McSparrin and Barker, the line foreman and superintendent, both testify that it was Blake's duty to report to them any defects he might discover; and thus it was made plain that it was Blake's duty to take notice of defects in the plant coming under his observation, and to report the same when discovered; and therefore, within the doctrine of the authorities cited, the court was justified in instructing the jury that knowledge acquired by Blake of the defective condition of the pole, when he was going his rounds as employe of the company, would be imputable to the company, because it was proven beyond dispute that it was his duty to take notice of defects, and, noticing them, to make report thereof. \* \* \*

*Reversed on other grounds.*

*Notes.* See note to preceding case. 1901, *Wheeler v. Grand Trunk Ry. Co.*, — N. H. —, 50 Atl. 103.

DIVISION II. INDIVIDUAL RELATIONS.

TITLE I. INTERNAL RELATIONS.

CHAPTER 18.

RELATION OF PROMOTERS, SHAREHOLDERS, OFFICERS,  
ETC., AMONG THEMSELVES, TO ONE ANOTHER,  
AND TO OTHER PARTIES.

SUBDIVISION I. PROMOTERS.

Sec. 605. 1. Relation to the state.

See *Walker v. Devereaux*, 4 Paige Ch. 229, *supra*, p. 385, note, *supra*, p. 390.

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Sec. 606. 2. Relation to the corporation, the shareholders,  
and to third parties.

See, *supra*, §§ 506-511, 607.

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Sec. 607. 3. Relations among themselves.

ROBERTS MANUFACTURING COMPANY v. FRANK SOHLICK, JR.<sup>1</sup>

1895. IN THE SUPREME COURT OF MINNESOTA. 62 Minn. Rep.  
332-334.

START, C. J. Briefly stated, the facts in this case are that certain individuals, named in the second subdivision of the findings of the trial court, on February 28, 1893, associated themselves together for the purpose of forming a corporation, securing a bank charter, and engaging in a general banking business as the Metropolitan National Bank of St. Paul, Minnesota, under the provisions of the national bank act. They executed articles of association, elected directors and other necessary officers. The defendant was not one of the original associates or promoters, but on April 15, 1893, he was chosen a director to fill a vacancy caused by a resignation, accepted the position, and thereafter acted as a director of the association. The board of directors, through its authorized committee, entered into certain contracts, for the association, and in its proposed corporate name, for the lease of a banking office, and for a safe and the necessary office furniture and fixtures. The contract for the latter was made with the

<sup>1</sup> Arguments and part of the opinion omitted.



plaintiff on April 19, 1893, by a committee appointed by the board of directors before the defendant became a member. After the performance of this contract by the plaintiff on its part, the promoters voluntarily abandoned their purpose of becoming a corporation and engaging in the banking business, and are not, and never were, a corporation. All the promoters except the defendant and one other have paid their proportionate share of the amount due to the plaintiff on its contract, and have been released by it from further liability therefor.

This action was brought to recover from the defendant the balance of his proportionate share of such amount. The trial court found substantially the foregoing facts, and other evidential facts, and ordered judgment for the plaintiff for the amount claimed, and from an order denying his motion for a new trial the defendant appealed.

1. The plaintiff claims that the defendant is liable as a partner, but we neither discuss nor decide this question, for we are of the opinion that the defendant, in any view of the case, is liable upon the general principles of contract and agency. Where individuals associate themselves for the purpose of promoting and organizing a corporation for the pecuniary gain of its members, and act as an association by electing directors and other officers, through whom contracts are made for and in the name of the proposed corporation, and they afterwards abandon their purpose to form a corporation, their relation, one to the other, as to persons dealing with the association, if not that of partners, is that of agent and principal, and each will be individually liable upon any contracts of the association which he directly or indirectly authorized or ratified.

The defendant vigorously challenges the sufficiency of the evidence to bring him within this rule, and insists that there is no evidence in the case that he ever authorized or ratified the contract in question. Where, as in this case, it is shown that the defendant was one of several promoters, and that all acted as a body by a board of directors, and that he was a member thereof, only slight additional evidence is required to establish *prima facie* his authorization or ratification of contracts made in the name of the association, whether they were made before or after he became a director. We are of the opinion that the evidence in this case is ample to sustain the material findings of fact and conclusion of law of the trial court to the effect that the defendant is liable on the contract in question. The evidence shows that the promoters organized by electing a board of directors, president, cashier, and other officers, and that business was done by the board, which kept a correct record of all its acts and proceedings. At its first meeting, March 2, 1893, a committee on location and fixtures for the bank, consisting of three directors, one of whom was the cashier, was appointed. This committee reported at the second meeting held on March 15, the terms upon which a lease of an office could be secured, and the board accepted the terms, and authorized the committee to take the lease. The defendant, at the third meeting, April 15, was elected a director, and at this meeting the committee reported in favor of accepting the bid of the plaintiff for office

fixtures, and the report was referred back to it to enter into and complete the contract in their discretion, which it did on April 19. The defendant was not present at any of these meetings, but at the fourth meeting, April 18, he was present as a director, and was present at all subsequent meetings, acting as a director, up to and including June 29, 1893. At the first meeting at which he was present as a director the board voted \$300 for advertising purposes, and at the last one it appointed a committee to arrange the best possible adjustment of all claims against the bank under contracts with various parties.

This evidence tends to show that the promoters were acting as an association under a common name, promoting the common enterprise by and through its representatives, its directors, of whom the defendant was one; and that he had ample opportunity to learn, and in the exercise of ordinary prudence and sagacity in the discharge of his duties as director he must have learned, by an examination of the records, of the making of this contract here in question. The records were not voluminous, and afforded the defendant the ready means to learn all about the association he was acting for. It is for this reason that the records of the proceedings of the board of directors prior to the time the defendant became a member thereof were properly received in evidence, notwithstanding his objection to such evidence. The articles of association, although not executed by the defendant, were correctly received in evidence, for they show the organization and purposes of the association, of which he afterwards became a member. If the defendant knew that the board of directors had made and were making contracts for and in the name of the association as a reasonable, necessary work of preparation for doing a general banking business when it should become incorporated, and with such knowledge he continued to take an active part in the proceedings of the board as a director, without objection or protest, it would tend to show a ratification of this contract. If he did not do so, and had no notice of the making of this contract, it was a matter peculiarly within his own knowledge; yet he was not a witness on the trial, and there is no explanation of his significant silence. The undisputed evidence tends further to show that he knowingly and without objection, through a third party, paid to the plaintiff \$50 on this contract. No further evidence was necessary to make a strong *prima facie* case against the defendant. \* \* \*

*Affirmed.*

*Note.* Compare, 1822, *Holmes v. Higgins*, 1 B. & C. 74; 1846, *Reynell v. Lewis*, 15 M. & W. 517; 1852, *Bright v. Hutton*, 3 H. L. Cas. 340; 1853, *Batard v. Hawes*, 2 El. & B. 287; 1859, *Hamilton v. Smith*, 5 Jur. (N. S.) 32; 1889, *Abbott v. Hapgood*, 150 Mass. 248; 1902, *Friedman v. Janssen*, — Ky. —, 66 S. W. 752.

SUBDIVISION II. SHAREHOLDERS OR MEMBERS.

**Sec. 608.** 1. Relation to the state.

See *Trustees of Dartmouth College v. Woodward*, 4 Wheat. 518, *supra*, p. 708; *Tomlinson v. Jessup*, 15 Wall. 454, *supra*, p. 754; *Ireland v. The Palestine, etc., Co.*, 19 Ohio St. 369, *supra*, p. 757.

*Note.* Shareholders rights are determined by the state creating the corporation; 1900, *Fish v. Smith*, 73 Conn. 377, 84 Am. St. R. 161.

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**Sec. 609.** 2. Relation to the corporation, promoters and officers.

See *supra*, §§ 513-585, 506-512, 586-604, 607.

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**Sec. 610.** 3. Relation among themselves.

- (a) Right to good faith upon the part of fellow-subscribers to the stock.

See *White Mountains R. R. v. Eastman*, 34 N. H. 124, *supra*, p. 758.

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**Sec. 611.** Same.

- (b) Right to equality, in proportion to stock owned.  
(1) In management:

Voting, see *supra*, §§ 534-541; notice of meetings, see *Stowe v. Wyse*, 7 Conn. 214, *supra*, p. 835.

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**Sec. 612.** Same.

- (2) In the distribution of profits:

See *supra*, §§ 542-549.

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**Sec. 613.** Same.

- (3) In contributing to the corporate enterprise: Equality and uniformity of calls:

See *supra*, §§ 519, 520, 521.

**Sec. 614. Same.**

(4) In discharging corporate debts.

DAVID BENNISON ET AL. v. JOSEPH H. McCONNELL ET AL.<sup>1</sup>

1898. IN THE SUPREME COURT OF NEBRASKA. 56 Neb. Rep.  
46-50.

RAGAN, C. In 1888 there was organized, under the laws of this state, and domiciled in the city of Omaha, a corporation known as the Guaranty Loan and Investment Company. This corporation was organized for the purpose of negotiating real estate loans and guarantying the payment of the same. The authorized capital stock of the company was subscribed; but it seems that each subscriber paid in cash for only a part of the stock subscribed for by him, giving his note to the corporation for the remainder of the subscription. The corporation made a loan of \$6,500, which was secured by a mortgage upon real estate. It then sold this mortgage loan to one Bertha Zenner, guarantying the payment of the same. The loan was also guarantied by John L. Kennedy and David Bennison and other stockholders of the corporation. Early in 1889 the stockholders of the corporation held a meeting, and, because it was not doing a profitable business, resolved to wind up its affairs. At this meeting the stockholders set aside out of the company's funds \$500 to be used in defraying future expenses, "liabilities, and needs." They also levied an assessment of three per cent. on the stock for the purpose of covering losses of the company, and by resolution returned to each stock subscriber seventy-seven per cent. of the cash paid by him on the stock for which he had subscribed, called in the outstanding stock and canceled it, and surrendered to each stock subscriber his note. Some four years after this, Bertha Zenner foreclosed the mortgage which had been sold to her by this investment company, and caused the property mortgaged to be sold; but the proceeds of the sale were not sufficient to satisfy the mortgage debt, and Zenner took a deficiency judgment against the investment company. John L. Kennedy and David Bennison, two of the stockholders in said investment company, and who had guarantied the payment of the mortgage sold by it to Zenner, then advanced the money to Zenner on the deficiency judgment, and took from her an assignment thereof to themselves. An execution was then issued on this deficiency judgment against the investment company, and returned wholly unsatisfied; and thereupon Bennison and Kennedy brought this suit in equity in the district court of Douglas county, making the investment company and all the stock subscribers and creditors thereof parties. The object of Bennison and Kennedy's action was to recover from their co-stock subscribers their proportionate share of the mortgage debt which they had paid to Zenner. The district court dismissed Bennison and Kennedy's petition and they have appealed. \* \* \*

<sup>1</sup> Part of opinion omitted.

The district court placed its denial of the appellants' right to recover on the following grounds: "That the plaintiffs in this action are estopped from recovering from the defendant stockholders of the Guaranty Loan and Investment Company by reason of their participation in the distribution of the assets of the company, whereby they received back the notes which they had given in payment for their stock, and whereby a large amount of money then on hand was distributed to stockholders who had made cash payments upon their stock, a number of said stockholders being now without the jurisdiction of this court and are not parties to this suit." But we can not agree to this conclusion of the learned district judge. We are of opinion that the rule of estoppel should not be enforced against the appellants under the facts of this case. If at the time the stockholders met and resolved that the incorporation should go out of business, distributed its assets, called in its stock, and returned the stock subscribers' notes, this deficiency judgment against the corporation had been in existence, then it may be that Bennison and Kennedy, being stockholders of the investment company, could not afterward have purchased this judgment and enforced it against their co-stock subscribers. But when the distribution of the assets of the investment company took place, this deficiency judgment was not in existence; and it was not at that time within the contemplation of any of the stockholders that the corporation or themselves would be called upon to make good the company's guaranty. The appellants by participating in this distribution of the investment company's assets neither said nor did anything nor omitted to say or do anything which caused any other stock subscriber to change his status. These stock subscribers have not been injured by the distribution made of the investment company's assets; and, if it can not be said that they have, we are unable to see how the appellants are responsible for such injury. Again, it must be remembered that the distribution made of the assets of the corporation by the stockholders did not impair Zenner's right, after the corporate property was exhausted, to call upon the stock subscribers to the extent of their unpaid stock subscriptions for the satisfaction of her judgment. All the stock subscribers, after the exhaustion of the corporate property, became liable to the extent of their unpaid stock subscriptions to her for this deficiency judgment. The appellants were among these unpaid stock subscribers and therefore liable for this deficiency judgment; and, by paying the judgment and taking an assignment of it, they succeeded to the rights Zenner had; and, since she could enforce the judgment against the stock subscribers, any one of them liable might pay the judgment, take an assignment of it and enforce contribution against his co-subscribers. (*Van Pelt v. Gardner*, 54 Neb. 701.) \* \* \*

*Reversed.*

*Note. Accord:* 1895, *Brown v. Merrill*, 107 Cal. 446, 48 Am. St. Rep. 145; 1898, *Myers v. Sierra Val. S. & A. Assn.* 122 Cal. 669, 55 Pac. Rep. 689; 1900, *Moxham v. Grant*, 69 L. J. Q. B. 97, 81 L. T. R. (N. S.) 431, *infra*, p. 1794.

But in the case of the payment of the statutory penal liability it has been

said no contribution can be enforced (1889, *Sayles v. Brown*, 40 Fed. Rep. 8; but see, 1900, *Moxham v. Grant*, 69 L. J. Q. B. 97, *infra*, p. 1794). It is said, also, that when shares have, by agreement, been issued at a discount, those who have paid up the amount agreed can not be called upon by other shareholders to pay more (1894, *In re Ry. Time Tables Pub. Co.*, L. R., 1895, 1 Ch. Div. 255; 1897, *Peter v. Union Co.*, 56 Ohio St. 181, 46 N. E. Rep. 894).

**Sec. 615. Same.**

(5) In distribution of corporate assets upon dissolution.

**RE ANGLO-CONTINENTAL CORPORATION OF WESTERN AUSTRALIA, LIMITED.<sup>1</sup>**

1898. IN THE ENGLISH CHANCERY DIVISION. 67 L. J. Ch. 179, 78 L. T. R. (N. S.) 157, 46 Wkly. Rep. 413.

WRIGHT, J. \* \* \* In the present case 100,000 shares of 20s. each had been issued with 5s. paid up, and afterwards 25,000 more were issued in one block to persons who paid them up in full. The company is now in liquidation. After providing for the debts and expenses, a considerable sum remains in hand, and the question is on what principle that sum is to be distributed, or rather returned, to the shareholders? In *Ex parte Maude* (23 L. T. R. 749) there was in the company's articles of association no express provision for regulating the distribution of surplus assets. The shares had been unequally called up. After payment of the debts and expenses there remained a balance as in the present case, insufficient for the return of all the paid-up capital. It was held that the real question was not how profits should be distributed, but how a loss should be borne, and that the uncalled capital was as much liable to be called up for the purpose of meeting this loss as it would have been for the payment of debts; and the result was that after the capital account had been equalized by calling up, or treating as called up, unpaid capital, the whole resulting balance was returned in proportion to the amount paid up on each share, that is to say, to its whole nominal amount, and every shareholder lost the same percentage of what he had subscribed and paid. In *Birch v. Cropper* (61 L. T. R. 621) there was again no provision for regulating the distribution of surplus assets. The shares had been unequally called up. There was a large real surplus, *i. e.*, more than enough for the return of all the paid-up capital. North, J., and the court of appeal held that the paid-up capital must be returned and the balance distributed in proportion to the amount which had been paid up on the several classes of shares; but the House of Lords held that, after the capital paid had been returned, the balance must, in the absence of any different provision in the memorandum or articles of association, be distributed in proportion to the nominal amounts of the shares. Thus all equities were satisfied by the return of all capital paid, and there remained no reason for treating the surplus assets as held for

<sup>1</sup> Arguments and part of opinion omitted.



the shareholders in proportions differing from the amounts of their shares.

In the present case there is an express provision regulating the distribution of assets after payment of debts and expenses. Article 129 provides as follows: (His lordship read the article and continued:) The shares are all of the same nominal amount of 20s., but they are unequally paid up. There is no real surplus; for, although there is more than enough to pay the debts and expenses, there is not enough for the return of the capital paid up. Under these circumstances, and under this article, there is no room for the application of *Birch v. Cropper* (*ubi sup.*). Had there been a real surplus after returning the paid-up capital, it would, by the express terms of the contract, have been divisible, not according to the nominal amounts of the shares, but according to the amounts which had been paid up (subject to correction in respect to any arrears and advances), and which, therefore, had presumably had the principal merit in earning the profit. There being no such surplus, however, but a deficit on the whole adventure, there still remains an equity to be satisfied in order to equalize the loss, and the uncalled capital ought on general principles to be called up or treated as called up so far as is necessary for that purpose, unless the contract has otherwise provided. I think that it has not otherwise provided. It says that in the event which has occurred the surplus assets shall be distributed so that the losses shall be borne by the members in proportion to the capital paid (subject to correction in cases of arrears or advances) on the shares held by them respectively at the commencement of the winding up. What is the meaning of the term "capital paid?"

On a somewhat similar article it was held by the court of appeal, in *Re Sheppard's Corn Malting Company Limited*, *Ex parte Lowenfeld* (70 L. T. R. 3), that these words did not mean merely capital paid before the liquidation or called up in the liquidation for payment of debts and expenses, but must be held to include capital called up or treated as called up for the very purpose of satisfying equities in the repayment of capital. So in the present case. There is not in truth a surplus at all, but a mitigation of loss. The loss and the mitigation of it are, I think, intended to be distributed equally, but subject to equalization of the capital account, and not irrespectively of such equalization; and a call (actual or in account) is necessary for that equalization which is an essential part of a winding-up unless excluded by the contract; and the amount of that call must be included in the words "capital paid or which ought to have been paid." The same thing may be put in another way, as implied in the term "surplus assets," when used in relation to this subject-matter. So used, the term *prima facie* implies that the capital account must have been properly equalized before any balance can exist for a general and equal return of capital, or for equal division of profits. Then, how are the figures to be worked out? In my judgment the liquidator must proceed to make a call (either actual or imaginary, as the case may require) on the 100,000 shares sufficient to equalize the capital account. If all

the shareholders are solvent, the call in this case will be one of 3s. per share on the 100,000 shares, making them 8s. paid. The amount so obtained would be sufficient to repay to the holders of the 25,000 shares 12s. per share, leaving them also with 8s. paid. The assets in hand will then be divided equally amongst the whole 125,000 shares, and the ultimate loss of each shareholder will be the difference between the 8s. and the dividend so paid. Assuming the moneys in hand to be £25,000, then each of the 100,000 shareholders will, as a result of the whole, have received back 1s., and each of the 25,000, 16s., and every shareholder will have lost 4s. per share. The only alternative that I can see is to hold that every 5s. paid up is to abate equally; but on this alternative the result will be just the same as on the other, if "paid up" is to have the meaning assigned to it in *Re Sheppard's Corn Malting Company Limited, Ex parte Lowenfeld (ubi sup.)*; that is to say, is to include sums called up for equalization of the capital account. \* \* \*

*Note.* See, 1880, *McGregor v. Home Insurance Co.*, 33 N. J. Eq. 181; 1884, *Gordon's Exm. v. Richmond, etc.*, R., 78 Va. 501; 1888, *Re Bridgewater Nav. Co.*, 58 L. T. R. (N. S.) 866; 1889, *Birch v. Cropper*, 61 L. T. R. (N. S.) 621; 1891, *Re Bridgewater, etc., Co.*, 64 L. T. R. (N. S.) 576; 1894, *In re Railway Time Tables Pub. Co.*, L. R. (1895) 1 Ch. Div. 255; 1897, *Hamlin v. Continental Trust Co.*, 47 U. S. App. 422, *supra*, p. 785; 1897, *Peter v. Union Co.*, 56 Ohio St. 181, 46 N. E. Rep. 894; 1898, *In re Driffeld Gaslight Co.*, 67 L. J. Ch. 247, 78 L. T. Rep. (N. S.) 162, 46 Wkly R. 411; 1900, *Moxham v. Grant*, 69 L. J. Q. B. 97, 81 L. T. R. (N. S.) 431, *infra*, p. 1794; 1900, *MacMurray v. Sidwell*, 155 Ind. 560, 80 Am. St. Rep. 255, 58 N. E. 722.

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**Sec. 616. Same.** In case of preferred shareholders.

See *Hamlin v. Continental Trust Co.*, 47 U. S. Appeals 422, 36 L. R. A. 826, *supra*, p. 785.

*Note.* See preceding case and note.

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**Sec. 617. Same.** (c) Right to good faith upon the part of the majority: Power of the majority:  
(1) In the management of the corporate affairs:

See *Miner v. Belle Isle Ice Co.*, 93 Mich. 97, *supra*, p. 1323; *Wallace v. Pierce-Wallace Pub. Co.*, 101 Iowa 313, 63 Am. St. Rep. 389, *supra*, p. 1747; *Hawes v. Oakland*, 104 U. S. 450, *supra*, p. 1716.

Sec. 618. Same.

THE FARMERS' LOAN AND TRUST COMPANY, AS TRUSTEE, RESPOND-  
ENT, v. THE NEW YORK AND NORTHERN RAILWAY COM-  
PANY ET AL., RESPONDENTS, AND A. H. HOLMES  
AND A. R. PICK, APPELLANTS.<sup>1</sup>

1896. IN THE COURT OF APPEALS OF NEW YORK. 150 N. Y.  
Rep. 410-439.

[Appeal from judgment of general term of the supreme court in favor of plaintiff, in a suit to foreclose a second mortgage upon the property of the railway company, given by it to plaintiff as trustee to secure the payment of the second mortgage of \$3,200,000, providing that after one year's default in payment of the interest, and upon the written request of the holders of \$2,000,000 of the bonds, foreclosure proceedings should be instituted. The capital stock of the railway company was \$3,000,000 common and \$6,000,000 preferred. Default having been made, representatives of the holders of over \$2,000,000 of the bonds directed foreclosure proceedings to be commenced. None of the defendants interposed a defense, and Holmes and Pick, as shareholders, representing about 20,000 shares, on behalf of themselves and others, were allowed to put in an answer charging that the foreclosure proceedings were brought in pursuance of an unlawful plan and combination between the New York Central & H. R. R. Co. and others to render the stock of the N. Y. & N. R. Co. valueless, and secure its property for the benefit of the New York Central. And in order to do this it had purchased a large amount of the bonds, and a majority of the stock of that company, and had procured the resignation of three of the directors of that company, appointed others in their places, and displaced two other prominent officers thereof and filled their places by those in the employ of the New York Central, and thereby had obtained control of the N. Y. & N. Co., and had prevented it from taking measures for its safety, or save its default in payment of interest, all of which had been done "to secure the property through such foreclosure for its own benefit and at a price much less than its true value."]

MARTIN, J. \* \* \* (After holding that the evidence fairly established the foregoing facts, proceeded:) On the trial the appellants sought to prove that after the New York Central and Hudson River Railroad Company became the owner of such stock and bonds, and while its officers were in substantial control of the New York and Northern Railway Company, they declined to accept traffic from other roads that would have produced a fund with which to pay the interest due on the bonds in question; that the income of the road which should have been employed to pay such interest was used for other and improper purposes; and that such action caused the inability of the New York and Northern Railway Com-

<sup>1</sup> Statement much abridged; arguments and part of opinion omitted.

pany to pay the interest and thus cure its default. This evidence was rejected as immaterial and the appellants duly excepted.

In determining the correctness of the rulings made by the trial court, it becomes necessary to determine incidentally whether a corporation, purchasing a majority of the stock of another competing corporation, may thus obtain control of its affairs, cause it to divert the income from its business, or to refuse business which would enable it to pay the interest for which it was in default, and then institute an action in equity to enforce its obligations for the purpose of obtaining control of its property at less than its value to the injury of the minority stockholders, and they have no remedy. Or, in other words, whether a court of equity, with those facts established, would lend its aid to such a stockholder by enforcing the mortgage and decreeing a foreclosure and sale of the mortgaged premises, at its request, in its behalf, and to accomplish such a purpose. If it would, then the rulings of the trial court were proper; if not, then the appellants were entitled to prove those facts, and it was error to reject the evidence.

In *Gamble v. Q. C. W. Co.* (123 N. Y. 91), in discussing a similar question, Judge Peckham, in effect, said that, although it is not every question of mere administration or of policy upon which there might be a difference of opinion that would justify the minority in coming into a court of equity to obtain relief, yet, where the action of a majority of the stockholders of a corporation is fraudulent or oppressive to the minority shareholders, an action may be maintained by the latter, where the contemplated action of the majority is so far opposed to the interests of the corporation as to lead to a clear inference that such action is with an intent to serve some outside purpose, regardless of the consequences to the company and inconsistent with its interests. \* \* \*

(Quoting to the same effect from *Pondir v. N. Y., L. E. & W. R. Co.*, 72 Hun 384, 389; *Barr v. N. Y., L. E. & W. R. Co.*, 96 N. Y. 444; *Sage v. Culver*, 147 N. Y. 241; *Meyer v. Staten Island R. Co.*, 7 N. Y. St. Rep. 245; *Ervin v. Oregon, R., etc., Co.*, 27 Fed. Rep. 625; *Wright v. Oroville M. Co.*, 40 Cal. 20; *Meeker v. Winthrop Iron Co.*, 17 Fed. Rep. 48; *Goodin v. Cincinnati & W. C. Co.*, 18 Ohio St. 169; *Jackson v. Ludeling*, 21 Wall. 616; *Menier v. Hooper's Tel. Works*, L. R. 9 Ch. App. 350; *Gregory v. Patchett*, 33 Beavan 595.)

“The law requires of the majority of the stockholders the utmost good faith in their control and management of the corporation as regards the minority, and in this respect the majority stand in much the same attitude towards the minority that the directors sustain towards all the stockholders. Thus, where the majority are interested in another corporation, and the two corporations have contracts between them, it is fraudulent for that majority to manage the affairs of the first corporation for the benefit of the second. A court of equity will intervene and protect the minority upon an application by the latter.” (2 Cook on Stock and Stockholders (3d ed.), § 662, p. 945.) The

same principle is stated in 1 Morawetz on Private Corporations (2d ed., § 529); 1 Beach on Private Corporations (§ 70); 2 Bigelow on Frauds (§ 645), and Beach on Mod. Eq. Juris. (§§ 132, 686).

*Hackettstown Nat'l Bank v. D. G. Yuengling Brewing Co.* (15 N. Y. Law Jour. 541) is to the effect that every delegation of power implies that it will be honestly exercised, and in that case it was held that the evidence offered upon the trial presented a question of fact for the jury whether a consent, given in pursuance of a resolution passed by the majority of the bondholders of a corporation, extending the time of payment of the principal and interest of its bonds, was given in good faith in the common interest of all, or amounted to an unwarranted exercise of the power of the majority because given in the interest of one bondholder, with a view of enabling him to compel the minority bondholders to sell their bonds on such terms as he might dictate.

While the question in some of the cases cited arose between stockholders and directors and officers of a company who as such held a position of trust as to the former, still, where, as in this case, a majority of the stock is owned by a corporation or a combination of individuals, and it assumes the control of another company's business and affairs through its control of the officers and directors of the corporation, it would seem that for all practical purposes it becomes the corporation of which it holds a majority of stock, and assumes the same trust relation towards the minority stockholders that a corporation itself usually bears to its stockholders, and, therefore, under such circumstances, the rule stated in the *Sage* and other similar cases applies to majority stockholders who control the affairs of the company, as well as to its directors or officers.

It is a controlling maxim that a court of equity will not aid parties in the perpetration or consummation of a fraud, nor give any assistance whereby either of the parties connected with the betrayal of a trust can derive any advantage therefrom. (*Farley v. St. Paul, Minneapolis and Manitoba Ry. Co.*, 4 McCrary 138.) "It is a sound principle, that he who prevents a thing being done shall not avail himself of the non-performance he has occasioned." (*Fleming v. Gilbert*, 3 Johns. 527, 531; *United States v. Peck*, 102 U. S. 64; *Dolan v. Rodgers*, 149 N. Y. 491.)

The principle of these authorities renders it quite obvious that a corporation, purchasing a majority of the stock of another competing one, can not obtain control of its affairs, divert the income of its business, refuse business which would enable the defaulting company to pay its interest, and then institute an action in equity to enforce its obligations, for the avowed purpose of obtaining entire control of its property, to the injury of the minority stockholders. Such a course of action is clearly opposed to the true interests of the corporation itself, plainly discloses that one thus acting was not influenced by any honest desire to secure such interests, but that its action was to serve an outside purpose, regardless of consequences to the debtor company, and

in a manner inconsistent with its interest and the interest of its minority stockholders.

The respondents, however, contend that the doctrine of the authorities cited is not controlling in this case, but that the New York Central and Hudson River Railroad Company had a right to purchase a majority of the stock and bonds of the New York and Northern Railway Company, for the express purpose of obtaining control of the affairs of the latter for its own use and benefit, and to thus acquire its property at less than its actual value, to the injury of the minority stockholders, and that such stockholders had no remedy in law or in equity to protect themselves against such action of the majority stockholder, although it diverted the income which should have been applied to the payment of such interest to other and improper purposes, and refused business which would have enabled the defaulting company to pay its interest. In other words, the claim of the respondents is, and the general term in effect held, that the purpose for which the New York Central and Hudson River Railroad Company obtained a majority of the stock and bonds of the New York and Northern Railway Company is entirely immaterial, and that notwithstanding the existence of such a purpose, a court of equity will aid them in enforcing the mortgage. To sustain this contention they cite *Morris v. Tuthill* (72 N. Y. 575), *Phelps v. Nowlen* (72 N. Y. 39), *Chenango Bridge Co. v. Paige* (83 N. Y. 178), *Ramsey v. Erie R. Co.* (8 Abb. Pr. (N. S.) 174), *Clinton v. Myers* (46 N. Y. 511), *Simpson v. Dall* (3 Wall. 460), *Oglesby v. Attrill* (105 U. S. 605), *Adler v. Fenton* (24 How. (U. S.) 407), and *Beveridge v. N. Y. E. R. Co.* (112 N. Y. 1). \* \* \*

(After reviewing these cases and holding they were clearly distinguishable from the case at bar, proceeds:)

As we have already seen, there are circumstances under which the majority stockholders occupy substantially the same relation of trust towards the minority as the board of directors would occupy towards the stockholders it represents, and hence, where there are corrupt motives, personal interest or fraud, the case cited is an authority to sustain the conclusion which we have already reached.

That any person or corporation authorized to do so might have purchased the bonds of the New York and Northern Railway Company, and have rigorously enforced them by a sale of its property, there can be no doubt. They might also have purchased the stock of the company and thus have become the owners of both, and, while such owners, might have enforced the liability of the company upon its bonds, so long as they acted in good faith and their purpose was proper; but when the New York Central and Hudson River Railroad Company purchased the stock and bonds in question, thus obtaining a controlling interest in the affairs of the New York and Northern Railway Company for the avowed purpose of destroying it, to serve a purpose entirely outside of that for which it was organized, and in hostility to it, it becomes clear that as such stockholder it owed a duty to the minority stockholders, that the law implied a *quasi-trust* upon its part, and



that a court of equity will not aid it in the destruction of that corporation and a confiscation of its property, although it held a majority of its stock and the required amount of its bonds.

Hence, we are of the opinion that the court erred in rejecting as immaterial evidence offered by the appellants to show that, after the New York Central and Hudson River Railroad Company became the owner of a majority of the stock and bonds of the New York and Northern Railway Company, and while its officers were in control of the latter corporation and its affairs, it declined to accept traffic from other roads which would have produced a fund with which to pay the interest that was due; that the income of the road, which should have been employed to pay such interest, was used for other and improper purposes, and that such action upon the part of the majority stockholder occasioned the inability of the company to pay the interest and cure the default. To the rejection of this evidence the defendants excepted. We think many of these rulings were erroneous, and that the appellants had the right to make the proof offered, so far as it related to the transaction of the business of the New York and Northern Railway Company during the time the New York Central and Hudson River Railroad Company owned a majority of its stock and controlled its affairs, and for the error in those rulings the judgment should be reversed. \* \* \*

(Remainder of opinion on other points omitted.)

*Note.* See, 1858, *Lauman v. Lebanon Valley R. Co.*, 30 Pa. St. 42, 72 Am. Dec. 685; 1876, *Taylor v. Earle*, 8 Hun (N. Y.) 1; 1884, *Orr v. Bracken Co.*, 81 Ky. 593; 1898, *Rogers v. Nashville, C. & St. L. R. Co.*, 91 Fed. Rep. 299; 1898, *Henshaw v. Salt River Valley Canal Co.*, — Ariz. —, 54 Pac. Rep. 577; 1900, *Dickerman v. Northern Trust Co.*, 176 U. S. 181.

Sec. 619. Same. (2.) In selling all the corporate property.

FORRESTER ET AL. V. BOSTON AND MONTANA CONSOLIDATED  
COPPER AND SILVER MINING COMPANY.<sup>1</sup>

1898. IN THE SUPREME COURT OF MONTANA. 21 Mon. Rep.  
544-572.

[Suit by Forrester and another, as shareholders of the mining company, to enjoin the voting or allowing to be voted any of the stock of the company in favor of disposing of its assets to another company of the same name, and from ratifying or adopting any act or deed of conveyance for that purpose. The company was organized in Montana in 1887, with 150,000 shares of \$25 each, and had at the time suit was brought \$30,000,000 worth of property, very little debt, and an income of \$3,000,000 annually. Its mining operations were carried on in Montana, but its general offices were in New York City. Most of

<sup>1</sup> Statement much abridged, part of opinion and all of the opinion on the rehearing omitted.

the 1887 shareholders resided in the eastern states, and it was difficult and expensive to hold stockholders' and directors' meetings in Montana, as required by the laws of that state. To meet this difficulty, the directors April 5, 1898, incorporated and organized in New York a new company with the same name, and same amount of stock and shares, with offices in New York, to take all the property of the Montana company, assume all that company's liabilities, and issue to it all the shares of the new company to be exchanged share for share of the stock of the old company, or, at the option of the shareholder, to receive \$130 per share of the old stock. April 6, 1898, the directors executed a conveyance to the new company for this purpose, and called a meeting of all the shareholders, to be held June 6, 1898, to ratify the same. May 31, 1898, the written consent of the holders of 131,036 shares of the old company was obtained, and a new deed in conformation of the former was executed, similar to it in every way, except agreeing to pay \$170 per share to dissenting shareholders.

Plaintiffs became owners of one hundred shares each of stock April 8, 1898, having purchased the same from shareholders who had not consented to the proposed sale. They brought suit June 4, after formal protest against the proposed transfer, to enjoin the ratification of the same by the shareholders at the meeting to be held June 6; 131,036 shares were represented at this meeting, all in favor of, and would have been voted for, the ratification of the sale, if the injunction *pendente lite* had not prevented. The company offered to give bond to the amount of \$50,600, or any other sum, to purchase plaintiffs' two hundred shares of stock at the market value at any time, and pay all damages resulting from the proposed action. The court declined to accept the bond, and granted the injunction, and this is the order appealed from. At the time statutes provided as follows: Section 492. "The board of trustees of any mining company \* \* \* shall not have power to sell, lease, mortgage, or otherwise dispose of the whole or any part of the mining ground, quartz mills, smelters, \* \* \* etc., unless they shall first call a meeting of the stockholders \* \* \* for the purpose of submitting to them the propositions to sell, etc. \* \* \* Section 493. If \* \* \* stockholders shall appear in person or by proxy representing not less than three-fourths of all the shares, \* \* \*" and "at least two-thirds of all the shares of the capital stock" shall be voted in favor of selling, etc., "the chairman and secretary of such meeting shall make a certificate showing" the details of the vote, sign and verify the same under oath, enter the same at length on the corporate records, and a copy thereof, under the corporate seal, duly attested and acknowledged, shall be recorded in the office of the recorder of every county wherein any such property is situated. Section 494. "If a sale shall be made, as above provided, of the whole property, \* \* \* the corporation shall thereby be dissolved," etc.]

PIGOTT, J. \* \* \* (After holding that under the circumstances it was unnecessary to state or prove that plaintiffs had exhausted their remedies within the corporation, or for them to have been owners of

their shares at the time of the alleged transaction; also, that there was no error in the court below finding that plaintiffs were acting in good faith, and were not guilty of delay; also, there was no error in refusing to accept the bond, proceeds:) The question to be decided is involved in the statement that the directors and the holders of more than 87 per cent. of the shares of the Montana company are attempting to dispose of its entire property and business to the New York company, in exchange for the capital stock of the latter, against the objection of minority stockholders. The defendants claim that the power so to transfer exists, while plaintiffs assert that the action intended to be taken is *ultra vires* the corporation, employing that term in its strict sense as designating acts which are beyond the powers of a majority, or of any number less than all, of the stockholders, as against the minority.

At common law, neither the directors nor a majority of the stockholders have power to sell or otherwise transfer all the property of a going, prosperous corporation, able to achieve the objects of its creation, as against the dissent of a single stockholder. This doctrine is firmly established by the authority of adjudged cases, and rests upon the soundest principles. (Abbott v. Am. Rubber Co., 33 Barb. 578; People v. Ballard, 134 N. Y. 269, 32 N. E. Rep. 54, 7 Am. and Eng. Ency. Law (2d ed.) 734-736; Cook on Stock and Stockholders, § 667, and the numerous cases there cited.) Our attention is called to certain decisions which are said to recognize a contrary doctrine, but examination discloses no conflict of opinion among the various courts of last resort. Treadwell v. Manufacturing Co., 7 Gray 393, is typical of the cases relied upon by the defendants. A short extract from the opinion (page 405) will serve to illustrate the error into which counsel has fallen: "Upon the facts found in the case before us, we see no reason to doubt that the vote of the majority of the stockholders for the sale of the corporate property, and the closing of the business of the corporation, was justified by the condition of their affairs. Without available capital, and without the means of procuring it, the further prosecution of their business would be unprofitable, if not impracticable. Under these circumstances, it was in furtherance of the purposes of the corporation to pay their debts, close their affairs and settle with their stockholders on terms most advantageous to them." In that case, as in every one cited by the defendants, the corporation was unable further to prosecute the purposes for which it was created.

By the common law, the acts complained of are void. If the stockholders possess the power asserted to reside in them, statutory authority must confer it. Defendants earnestly contend that such power is given by an act entitled "An act in relation to alienation of mining property by corporations," approved March 9, 1887, and carried into the fifth division of the compiled statutes of 1887, as sections 492, 493 and 494. \* \* \*

Defendants argue with much vigor, and some plausibility, that these sections constitute an enabling act, which grants to stockholders

owning two-thirds of the shares the power to dispose of all the property of a solvent and prosperous corporation despite the protest of other stockholders. Now, by the common law, a solvent and prosperous corporation may, with the unanimous consent of its stockholders, dispose of its entire assets, but may not do so without such unanimity. Again, at the common law, a corporation which is insolvent or unable to execute the purposes for which it was created may, by its directors (or, at least, by the directors and a majority of its stockholders), sell or assign all its property when the best interests of the stockholders would be served thereby. In the proper pursuit of its business, and within the purposes for which it was created, a corporation may, by the common law, sell, lease or mortgage any part of its property, though the minority, or perhaps the majority, of the stockholders dissent.

Have the statutes quoted altered the common law in the respects mentioned? It is to be borne in mind that the common law, so far as it is applicable and of a general nature, and not in conflict with the constitution or with special enactments of the legislative assembly, is the law and rule of decision in this state, and is in full force until repealed by statute. Such is the declaration of section 201, division 5, compiled statutes of 1887. It is to be observed, also, that a statute is not presumed to work any change in the rules of the common law beyond what is expressed in its provisions, or fairly implied in them, in order to give them full operation. For the written law to effect a repeal of those doctrines of the common law which are not unsuited to our condition, the intent of the legislature to bring about the change must be clear; and, if the intent be not fairly evident, the common law remains the rule of decision. \* \* \*

By section 450, division 5, compiled statutes of 1887, it is provided that the stock, property and concerns of an industrial corporation shall be managed by trustees; and section 482 of the same division declares that every such corporation has power, among other things, "to hold, purchase and convey such real and personal estate as the purposes of the corporation may require." Sections 450, 482, 492, 493 and 494, *supra*, should be read together as one statute. In our opinion, sections 492 to 494, inclusive, were intended for the protection of stockholders in a mining corporation. The legislative assembly seemed to be of the opinion that the interests of stockholders in such corporations were not sufficiently guarded by the principles of the common law, under which a sale, mortgage or lease, or an assignment for the benefit of creditors, could be made by the trustees or directors alone, or by them with the consent of the majority of the shares, provided the exigencies of the corporation required such disposition to be made; and for that reason, doubtless, it enacted sections 492, 493 and 494, *supra*. By section 492 the trustees are declared to be without power to sell, lease, mortgage or otherwise dispose of certain mining property of their corporation, without first calling a meeting of the stockholders; and by section 493 it is provided that, if two-thirds of the stockholders vote in favor of the proposition submitted, a certifi-

cate of that fact shall be made and recorded in the office of the recorder of the county in which the property is situate. Neither of these sections declares that the trustees or corporation may sell at all. In section 494 there is, at most, an implication only that a sale may be made if not less than two-thirds of the shares consent thereto. If a sale of the whole of the property results from proceedings conducted in conformity with the provisions of sections 492 and 493, the corporation is thereby dissolved, and its affairs must be wound up according to the provisions of section 489 by a division among the stockholders of the money and other property that shall remain after the payment of the debts and necessary expenses.

Where, under sections 450 and 482, the directors would have the right, at least with the consent of a majority of the shares, to convey or otherwise dispose of the property mentioned in section 492, they may not now do so without the consent of the stockholders owning two-thirds of the shares. As we have said, at common law the directors (at least with the consent of the majority of shares) may sell the entire corporate property when the exigencies of a waning business require such action; while, to sell the entire property of a going, prosperous corporation, the consent of all the stockholders is necessary. In view of the language of the statutes quoted, there is strong reason to believe that the legislative assembly intended to prevent the alienation of the mining property specified in section 492, in any and all cases, without the consent of two-thirds of the shares. The language used in that section, being negative and prohibitory, and not permissive, also favors the conclusion that the statute was intended as a limitation upon the common-law powers possessed by the directors and a majority of the shareholders, and not as a grant of power. The statute operates, not as an enlargement, but as a restriction, of corporate power. Another consideration may be suggested as lending support to this conclusion: A transfer or other disposition of all its property will not, *ipso facto*, dissolve a corporation, although the practical effect thereof may be to defeat the object of its organization. This is so, because ownership or possession of property is not essential to corporate existence. (Gans v. Switzer, 9 Mont. 408, 24 Pac. Rep. 18; 9 Am. & Eng. Ency. Law (2d ed.) 565.)

A flourishing mining corporation may desire to sell or otherwise dispose of its entire assets for the purpose of reinvesting the proceeds in a new enterprise within the corporate purposes, or of acquiring other mining property. Such sale or other disposition might be made at common law with the unanimous consent of the stockholders, without working a dissolution; nor would a dissolution be produced by the sale or assignment of the whole property of an insolvent corporation made by the directors, either with or without the consent thereto of all the stockholders therein. It does not seem that the legislature, when it enacted sections 492 to 494, *supra*, intended that the dissolution of a prosperous mining corporation, able to continue its existence and to accomplish the objects of its creation, should be brought about by the mere fact that it has sold all its assets. It was, however, the



evident design of the legislature that a sale, made under sections 492 and 493, of the entire property of an insolvent mining corporation, or of one unable to perform the objects of its organization, should effect its dissolution; and that any transfer or disposition other than a sale would not have such an effect.

There seems to be reason for affording greater protection to stockholders in mining than to those in other industrial corporations. Mining, of all legitimate enterprises, is probably the most uncertain, and, indeed, precarious. Mines and mining claims are more subject to sudden and unexpected fluctuations in value (or seeming value) than is any other character of real property; and this is true in a peculiar degree as to those of gold and silver, which in 1887, when the act was passed, before the copper output of Montana was as considerable as it has since become, constituted the chief mining interest in the state. The temptation to sell or dispose of such property unadvisedly or fraudulently, and the facilities to that end recognized by the common law, induced the legislature to prohibit any transfer not consented to by two-thirds of the shares. \* \* \*

There is another reason why the attempted disposition of the property is *ultra vires* the corporation. Even if it be conceded that the act of March 9, 1897, is an enabling act, clothing the directors and the stockholders owning two-thirds of the shares with power not possessed at common law, yet the disposition intended to be made is not one authorized by the act. Manifestly, the transfer proposed lacks an element necessary to constitute a sale, namely, a pecuniary consideration. To constitute a sale there must, as a general rule, be a consideration in money. The proposed transaction is, at best, merely an exchange; and the defendants claim that the expression "or otherwise dispose of," used in section 492, operates to confer upon the corporation the power to exchange as well as to sell the entire property of the corporation without the consent of every stockholder therein. We do not think the general enumeration of the powers by the terms "sell, lease, mortgage, or otherwise dispose of" operates either to confer upon mining corporations the power to exchange, or as a recognition of it as already possessed by other industrial corporations. \* \* \*

It has been suggested that a power of sale must include the power to exchange, because the greater includes the less; but no such comparison can properly be made, as neither includes the other, and neither is part of the other. In the event of a sale, properly and fairly conducted, whether by public auction, or sealed bids, or by any other method calculated to produce the best result attainable, each of the stockholders has an equal right to become the purchaser of the whole or any part of the corporate assets, each is equally interested in obtaining the highest price for the common property, and each is entitled to an equal *pro rata* share of the proceeds; but if the holders of any number of shares, however large, be authorized to exchange the corporate assets for the capital stock of a foreign corporation, the law furnishes no measure by which to determine the prudence or wisdom of the exchange, or to test the



fidelity of those clothed with the power and charged with the duty incident to such proceedings. If defendants' contention be correct that sections 492 and 493 contain a grant of power, these *quasi-trustees* may, when authorized by two-thirds of the shares, determine to convert the assets into cash and distribute the proceeds among those beneficially interested; but they can not change the nature of the trust estate except in the manner provided by law, and they can then do so only for the purpose of continuing operations in this state, and not for the purpose of transferring the *corpus* of the estate or its ownership to a foreign jurisdiction. (Taylor v. Earle, 8 Hun 1.)

It is true that, under our laws, the holders of the requisite majority of shares in a mining corporation may determine to abandon the mining industry, and, for example, embark in a manufacturing enterprise, by amending their charter, and may sell the mining assets and reinvest in proper purchases for the new corporate object; but these steps, however important, are part of the internal management of a domestic corporation, and must be conducted in accordance with our law. The power to exchange the corporate property for the capital stock of a foreign corporation is not incident to these proceedings. But there seems to be neither a sale nor an exchange nor other disposition of the mining property, within the meaning of the statute. "To otherwise dispose of" does not signify and include "to give away," within the meaning of the statute. The New York corporation is formed. It has no property. It possesses nothing but a name. Attempt is made in the name of the Montana company to convey its property to the New York company, for which the Montana company receives nothing in return. It does not exchange its property for other property. There is, in effect, simply a change of corporate habitation. So far as stockholders are concerned, they are, perhaps, permitted to exchange their shares in the Montana company for the same kind of property in another state, and the laws of Montana for the laws of New York. The statute does not provide that, by a two-third vote, stockholders shall exchange their shares for shares in another corporation, or in the same corporation with changed citizenship. It has no reference to such a scheme. A stockholder, we think, may not be compelled to take, in lieu of his stock in the Montana corporation, an equal number of shares in the New York corporation, or the value of those shares; nor can he be compelled to accept payment for his shares in any other way than that prescribed by the Montana statute on a dissolution of the Montana corporation. The Montana company conveys all its property, and gets nothing in return. If the trustees attempt to wind up its affairs, under section 489, *supra*, there would be nothing to distribute. The new company promises to issue certain of its shares to each Montana stockholder, but we are unable to see how he can be deprived of his interest in the Montana company without his consent. Our statutes do not seem to confer upon two-thirds of the stockholders of a solvent and prosperous corporation the right to take the citizenship of the corporation to another state, without the consent of all the stockholders. \* \* \*

*Affirmed.*

Pemberton, C. J., and Hunt, J., concur.

*Note.* See next case and note, and preceding case and note.

Sec. 620. Same.

TREADWELL AND ANOTHER v. SALISBURY MANUFACTURING COMPANY AND OTHERS.<sup>1</sup>

1856. IN THE SUPREME JUDICIAL COURT OF MASSACHUSETTS. 7  
Gray's (Mass.) Rep. 393-406, 66 Am. Dec. 490.

[Bill in equity by Treadwell as trustee under the will of one C. holding forty shares of stock in the manufacturing company, in order to obtain the advice of the court as to whether the trustees could, under the will, exchange stock in the manufacturing company for the stock of a proposed new corporation by the name of the Salisbury Mills, which it was alleged had been or was about to be organized for the purpose of taking the property of the manufacturing company. It was averred that at a stockholders' meeting it had been voted by the majority, against the wishes of the minority, and the protest of one of the plaintiffs, that the officers of the manufacturing company have authority to sell at public or private sale all the real estate, machinery, etc., as they think will best promote the interest of the stockholders, provided, if a sale is made to a new company the old stockholders shall have a right to take an interest in the new company in proportion to their holdings in the old company; it averred further that the directors were about to sell all the real property of the old company to the new company for \$250,000,—much less than it was worth,—take payment therefor in stock of the new company, and divide it among the shareholders *pro rata* according to their holdings in the old company, and close up its affairs and surrender its charter. It averred also that said votes were illegal and void; also that the directors of the old company were directors of the new, and the sale would in effect be by trustees in one capacity to themselves in another, and therefore void. The answer substantially admitted the allegations of the bill, except as to the invalidity of the acts, and stated that it was the intention to make the sale for the purpose of paying the debts, winding up the affairs, and distributing the property, either in stock of the new company or by payment of cash received from the sale thereof,—and that the same was “an expedient and just act towards themselves and their creditors that it should be dissolved and wound up.” Evidence was introduced to show the debts were about \$1,000,000, and that the corporation could not go on without raising two or three hundred thousand dollars; that there was nearly enough personal property to pay their debts; that the property had never been appraised, and would not bring nearly \$250,000 at auction; and that “the proposed arrangement was the only proper and feasible course for the company to pursue, and if the plan was not perfected the company must stop business.”]

<sup>1</sup> Statement much abridged. Arguments omitted. Only the part of the opinion relating to the one point given.

BIGELOW, J. \* \* \* (After holding the fact that plaintiffs were trustees under a will, did not give a court of equity jurisdiction of such a case, proceeds:) But we entertain no doubt of the right of a corporation, established solely for trading and manufacturing purposes, by a vote of the majority of their stockholders, to wind up their affairs and close their business, if in the exercise of a sound discretion they deem it expedient so to do. At common law, the right of corporations, acting by a majority of their stockholders, to sell their property is absolute, and is not limited as to objects, circumstances or quantity. Angell and Ames on Corp., § 127, *et seq.*; 2 Kent Com. (6th ed.) 280; Mayor, etc., of Colchester v. Lowton, 1 Ves. & B. 226, 240, 244; Binney's Case, 2 Bland 99, 142. To this general rule there are many exceptions, arising from the nature of particular corporations, the purposes for which they were created, and the duties and liabilities imposed on them by their charters. Corporations established for objects *quasi*-public, such as railway, canal and turnpike corporations, to which the right of eminent domain and other large privileges are granted in order to enable them to accommodate the public, may fall within the exception; as also charitable and religious bodies, in the administration of whose affairs the community or some portion of it has an interest to see that their corporate duties are properly discharged. Such corporations may perhaps be restrained from alienating their property, and compelled to appropriate it to specific uses, by mandamus or other proper process. But it is not so with corporations of a private character, established solely for trading and manufacturing purposes. Neither the public nor the legislature have any direct interest in their business or its management. These are committed solely to the stockholders, who have a pecuniary stake in the proper conduct of their affairs. By accepting a charter, they do not undertake to carry on the business for which they are incorporated indefinitely, and without any regard to the condition of their corporate property. Public policy does not require them to go on at a loss. On the contrary, it would seem very clearly for the public welfare, as well as for the interest of the stockholders, that they should cease to transact business as soon as, in the exercise of sound judgment, it is found that it can not be prudently continued.

If this be not so, we do not see that any limit could be put to the business of a trading corporation, short of the entire loss or destruction of the corporate property. The stockholders could be compelled to carry it on until it came to actual insolvency. Such a doctrine is without any support in reason or authority. The case of Ward v. Society of Attorneys, 1 Collyer 370, cited by the plaintiffs, does not support it. They were not a trading corporation, nor were their affairs in an embarrassed condition. It was the case of a majority of a corporation attempting to surrender the old charter, and to pervert the corporate funds to a different purpose, by passing them over to a new association. Besides, the questions raised in the case were not finally determined by the vice-chancellor. They were only considered so far

as it was necessary to decide the question of granting an injunction preliminary to the hearing.

Upon the facts found in the case before us, we see no reason to doubt that the vote of the majority of the stockholders for the sale of the corporate property and the closing of the business of the corporation was justified by the condition of their affairs. Without available capital, and without the means of procuring it, the further prosecution of their business would be unprofitable, if not impracticable. Under these circumstances it was in furtherance of the purposes of the corporation to pay their debts, close their affairs and settle with their stockholders on terms most advantageous to them. *Sargent v. Webster*, 13 Met. 504.

Nor can we see anything in the proposed sale to a new corporation, and the receipt of their stock in payment, which makes the transaction illegal. It is not a sale by a trustee to himself for his own benefit; but it is a sale to another corporation for the benefit and with the consent of the *cestuis que trust*, the old stockholders. The new stock is taken in lieu of money, to be distributed among those stockholders who are willing to receive it, or to be converted into money by those who do not desire to retain it. Being done fairly and not collusively, as a mode of payment for the property of the corporation, that transaction is not open to valid objection by a minority of the stockholders. *Hodges v. New England Screw Co.*, 1 R. I. 312, 347.

It was urged by the plaintiffs that the common law right of a corporation to sell their property and close their business had been taken away by St. 1852, ch. 55. But we do not think that such is its true interpretation. It is not restrictive in its terms, but only permissive. It was intended to provide a mode in which the charter of a corporation might be dissolved without a resort to the legislature. But it did not take away the right of a corporation to proceed in the sale of their property preparatory to a surrender of their charter, which is all that the defendants undertook to do. \* \* \*

*Bill dismissed.*

*Note.* See, 1899, *Phillips v. Prov. Steam Eng. Co.*, 21 R. I. 302, 45 L. R. A. 560. Compare preceding case and, 1858, *Lauman v. Lebanon Valley R. Co.*, 30 Pa. St. 42, 72 Am. Dec. 685, and, 1876, *Taylor v. Earle*, 8 Hun (N. Y.) 1; 1901, *Noble v. Gadsen Land Co.*, 113 Ala. 250, 91 Am. St. R. 27, note, p. 33.

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Sec. 621. Same. (3) In surrendering the corporate charter.

See *Mechanics' Bank v. Heard*, 37 Ga. 401, *supra*, p. 877; *Merchants' & P. L. v. Waganer*, 71 Ala. 581, *supra*, p. 880.

**Sec. 621a. Same. (4)** In accepting material amendments.

See *Stevens v. Rutland & B. R.*, 29 Vt. 545, *supra*, p. 1448; *Sprague v. The Illinois R. Co.*, 19 Ill. 174, *supra*, p. 1454; *Buffalo & N. Y. C. R. v. Dudley*, 14 N. Y. 336, *supra*, p. 1461; *Durfee v. Old Colony, etc., R. Co.*, 5 Allen 230, *supra*, p. 1462; *Zabriskie v. Hackensack R.*, 18 N. J. Eq. 178, *supra*, p. 1466.

*Note.* See, also, 1899, *Pronick v. Spirits Dist. Co.*, 58 N. J. Eq. 97, 42 Atl. Rep. 586. Cf. 1900, *Looker v. Maynard*, 179 U. S. 46.

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**Sec. 622. 4.** Relation of shareholders and creditors.

See *infra*, Creditors and Shareholders, §§ 670–727.

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**Sec. 623. 5.** Relation of shareholders to third parties.

See *Rider v. Fritchey*, 49 Ohio St. 285, *infra*, p. 1994.

*Note.* See, 1901, *Boddy v. Henry*, — Ia. —, 52 L. R. A. 769.

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SUBDIVISION III. OFFICERS.

**Sec. 624. 1.** Relation to the corporation.

See *supra*, §§ 586–601.

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**Sec. 625. 2.** Relation to shareholders.

(a) Rights of shareholders.

(1) Individual: When the right to vote, or to receive dividends or to inspect books, or to transfer shares, is interfered with, see *supra*, §§ 529, 534, 542, 551, 554, 568.

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**Sec. 626. Same. (2)** Collective,—only secondary in case the corporation does not, or will not, or can not, act.

See *supra*, §§ 579–594.

Sec. 627.

(b) Rights of officers.

(1) To deal with shareholders: officers are not trustees for shareholders.

JAMES G. DEADERICK ET AL. v. R. T. WILSON ET AL.<sup>1</sup>

1874. IN THE SUPREME COURT OF TENNESSEE. 8 Baxter (67 Tenn.) Rep. 108-141.

[Bill by Deaderick and some other stockholders, and others who had before suing sold their stock in the East Tenn., V. & G. R. R. Co., against Wilson and others constituting the board of directors, charging them both officially and individually with conceiving and executing a scheme of speculating in the stock of the railroad company to the damage of the other owners and to the gain of themselves. Other facts are sufficiently stated in the opinion.]

FREEMAN, J. \* \* \* Stripped of all verbiage, this charge is, simply, that officers and directors of a railroad corporation have purchased stock of parties owning small amounts of stock at below the par value of the stock, and below the value which they foresaw it would command—that is, in the future—and that they so purchased because of their superior knowledge of the real value of stock, or their superior foresight as to its future value, which knowledge was obtained by means of their official positions.

The legal proposition that underlies it, on which relief is sought, and the charge made, is that the officers and directors of a corporation of this kind are trustees for the stockholders, or individual owners of the stock, and, as such, can not be allowed to make a profit out of their trust—the rule applicable to all trustees in courts of equity. On the correctness and accuracy of this proposition all this branch of the case made by the bill turns, assuming for the present, but not deciding, that complainants have presented themselves properly before the court to obtain this relief. To this question we now address ourselves.

Numerous cases, both in England and this country, have settled that the position of a director is in some sense one of a fiduciary character; in most of them directors are stated to be trustees for the stockholders. That this is true in some particulars is beyond all question. See cases of *Overend, Gurney & Co. v. Gibb*, 3d vol. Eng. R. 7-17; *Liquidators v. Coleman*, 6th vol. Eng. R. 26-33; 1 Redf. on Railway 576, and numerous authorities cited in printed brief of Shields, Counsel, pp. 29, 30, 31; also cases collected in *Board of Commissioners of Tippecanoe County v. Reynolds*, June number Amer. L. Reg., p. 376, decided by supreme court of Indiana [44 Ind. 509]. To call directors of a corporation trustees for the stockholders, however, without limiting the use of this term by the facts of the cases in which the question has been presented for adjudication, is calculated to mislead and induce a very wrong conclusion as to the liabilities of officers, or

<sup>1</sup> Statement abridged. Part of opinion omitted.



rather agents, of corporations. As said by Judge Sharswood in *Spering's Appeal*, 71 Pa. St. 11, Am. Rep., vol. 10, p. 689: "It is by no means a well settled point what is the precise relation which directors sustain to stockholders. They are undoubtedly said in many authorities to be trustees, but that, I apprehend, is only in a general sense, as we term an agent or any bailee intrusted with the care and management of the property of another. It is certain they are not technical trustees."

This statement of the learned judge, we think, is correct beyond doubt. The officers and directors of a railroad corporation do not have the legal title of the corporate property vested in them as such, to be held by them for the use of the company or the stockholders; much less have they the title to or control of the individual shares of stockholders.

The corporation, the legal entity, owns the franchise and corporate property. The officers and directors are the agents through whom this legal entity acts, and, in the performance of the duties pertaining to their positions, represent the corporation. And so with reference to the stockholder, who, by virtue of his ownership as his individual property, is entitled to the dividends properly accruing to him as owner of such shares of stock, the officers and directors are under obligations to the faithful management and the use of the corporate franchises and property, so as to secure him the benefit of such dividends. In both cases they are responsible, under certain circumstances, in a proper proceeding in a court of equity, and probably in some cases in a court of law, for any wrong conduct in violation of the rights of either the corporation or injuriously affecting the interests in which the stockholder is concerned. In a word, they are agents charged with the performance with fidelity of the duties that grow out of their position, as defined by the powers, objects and purposes of the charter of the company. To this extent is their position fiduciary, and for breaches of good faith in the performance of these trusts they are held responsible. \* \* \*

But do these principles sustain the argument of complainants, and the theory of their bill on this branch of the case? It is, first, that the shares of stock, amounting to ten thousand, sold by defendants, Thomas A. Scott, or Security Company, be declared null and void, for reasons that will be referred to hereafter. Second, if this is not done, then that defendants be held to account to the stockholders from whom they purchased, on what stock they purchased from them, for all profits realized by said purchase and sale; and this on the ground that the officers and directors were trustees in such a sense as to forbid their purchasing the shares of stock owned by individual stockholders, except under the stringent rules that govern as between trustee and beneficiary in a technical trust, or as between principal and agent, attorney and client.

It suffices to say, first, on this proposition, that we have been pointed to no case that holds such a doctrine, and we feel sure none can be found going this length. We are totally unable to see the application

of the principle invoked to the case in hand. The officers and directors of a corporation are charged with no trust, nor fixed with any duty, as far as we can see, as to the sale or disposition or transfer in any way of the shares of stock owned by the shareholder. They have no power to control its sale or transfer, are charged with no duty in reference to such sale or transfer, by reason of their official position.

\* \* \*

It certainly is not in the line of the duty of the president, directors, or other officers of a railroad company, to sell the shares of stock owned by the shareholders. If not, then as such they can be charged with no breach of trust or duty in connection with said transfer or sale growing out of their official relation to the company, for no such duty is imposed or trust assumed to be violated. Nor can it be said that such officers may not, as individuals, purchase and hold stock in the corporation of which they are members; certainly not, unless prohibited so to do by the legislature. No such prohibition is shown. In fact, we believe it is a general qualification in all corporations of this character that the directors and officers shall own stock, and in most cases, in order to be eligible to offices of a certain character, to own some considerable amount of it. There being no limit as to the amount which he may own, as a matter of course he may purchase it, and if he may do this, he must necessarily do so from an owner, and that must be a stockholder. Whether he owns much or little can have no possible bearing on the question of his right to sell, nor of the other to buy. After all, the simple question involved is, whether the officers and directors are free to purchase stock from a shareholder in the corporation on the same terms as others. To this there can be but one answer, that is, they may, unless prohibited by legislative restriction.

The true relation between directors and officers of a corporation and a shareholder is thus stated by Chief Justice Shaw in the case of *Smith v. Hurd*, 12 Met. 371, cited in A. L. R., vol. 13, p. 378: "There is no legal privity relation or immediate connection between the holders of shares in a bank, in their individual capacity, on the one side, and the directors of the bank on the other. The directors are not the bailees, the factors, agents, or trustees of such individual stockholders."

In the language of the supreme court of Indiana, in the case from which the above quotation is cited, "stock in a corporation held by an individual is his own private property, which he may sell or dispose of as he sees proper, and over which neither the corporation nor its officers have any control. It is the subject of daily commerce, and is bought and sold in market like any other marketable commodity." This is a clear and accurate statement of the relation of the parties on this subject. We refer to this case for a very complete review of the cases, both English and American, on this subject. See, also, *Delaware R. R. Tax*, 18 Wal. 206, 230, with authorities referred to by Field, J., as to the character of such property; also, in our State, 9 Yer. 490, 10 Yer. 197.

It being clear and beyond all question, both on sound principle and authority, that the directors or officers of the company were charged with no trust in reference to the sale or disposition, the management or control of the shares of stock owned by the individual stockholders, it follows that none of the responsibilities growing out of this relation attach to them in making such purchase from the stockholder as are contended for by complainant, and that this feature of the bill can not be maintained, and the demurrer was properly sustained on this question. \* \* \*

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Sec. 628. (2) To contribution or indemnity, where they are required to discharge corporate debts for which shareholders are also liable.

MOXHAM ET AL. V. GRANT.<sup>1</sup>

1899. IN THE ENGLISH COURT OF APPEAL. 69 L. J. Q. B.  
97-102.

A. L. SMITH, L. J. This is an appeal from a decision of a divisional court affirming the judgment of the judge of the Swansea County Court in favor of the plaintiffs. The action was brought by directors of a company named Cory's Steamers, Lim., to recover from the defendant, a shareholder in the company, a sum of £35 15s., which they had paid to him, and had subsequently been compelled to pay to the liquidator of the company. The company owned, as part of its capital, a steamship named the Primrose. This vessel was lost, and the underwriters paid to the company a sum of money in respect of the loss. There can be no doubt that this money was a part of the capital of the company, but the directors and the shareholders came to an agreement to divide it, and the defendant received £35 15s. as his share. This, therefore, is not a case in which money has been paid by the directors of a company to a shareholder who has received it in ignorance of the fact that he had no right to it, but a case in which it was known to all concerned that that which was being paid to and received by the shareholder was a part of the capital of the company. If proper steps had been taken to reduce the capital of the company everything would have been in order, but unfortunately this course was not taken. After the money had been divided the company got into difficulties, and a winding-up order was made against it. A liquidator was duly appointed, and he inquired what had become of the money which represented the lost ship, and found that it had been divided amongst the shareholders. In these circumstances it was open to the liquidator to sue every one of the persons who had received portions of the money or to sue the directors for the whole amount. He took the latter course, and recovered the amount from the directors. Thereupon the directors asked the shareholders to re-

<sup>1</sup> Arguments and part of opinions omitted.

pay to them the money, part of the capital of the company, which the shareholders had received and which the directors had been compelled to pay to the liquidator, and the county court judge and the divisional court have held that they are entitled to recover it.

Now what was the position of the defendant when as a shareholder in the company he received this sum, with notice that it was part of the capital of the company? It seems to me that he occupied the position of a constructive trustee, in accordance with the ruling of Jessel, M. R., in *Russell v. Wakefield Water-works Co.* (1875), 44 L. J. Ch. 496, as being a person who had taken money from the company with notice that it was being applied to a purpose other than the special purposes of the company. That being so, what is the rule of equity applicable to the case of two trustees—the directors and shareholders—who are *in pari delicto*, one of whom has made good a loss occasioned by a breach of trust for which both are liable? It was settled long ago. I will refer to the case of *Chillingworth v. Chambers* (1896), 65 L. J. Ch. 343, where the matter was fully discussed before Lord Justice Lindley, Lord Justice Kay, and myself, and I will cite the third of the three rules which I there referred to as having application to that case, since it deals with the position in which the defendant is in this case. It is, “that as between two trustees who are *in pari delicto*, the one who has made good a loss occasioned by a breach of trust for which the two are jointly and severally liable may obtain contribution to that loss from the other”; and later on I said, “I now come to the third rule, which is, that, where two trustees concur in committing a breach of trust and are *in pari delicto*, the one, if he has made good the loss occasioned thereby to the trust estate, can obtain contribution from the other. The existence of this rule is not disputed at the bar—see *Lingard v. Bromley* (1812), 1 Ves. & B. 114.” Here it seems to me that the defendant took the money with notice that it was a part of the capital of the company, and was therefore a constructive trustee and *in pari delicto* with the directors; and as the directors have been compelled to pay back the money to the company, it follows, applying the rule of equity which I have cited, that they are entitled to recover it from the defendant.

For these reasons, I think that the divisional court was right in its decision. \* \* \*

COLLINS, L. J. \* \* \* The only possible answer to the claim of the person who has paid the sum to be recouped is that both persons were joint tort-feasors, between whom there is no contribution. Even at common law, as far back as 1834, Lord Dunman, in dealing, in *Betts v. Gibbins* (1834), 2 Ad. & E. 29, with the rule laid down in *Merryweather v. Nixan* (1799), 8 Term Rep. 186, says: “The general rule is, that between wrong-doers there is neither indemnity nor contribution; the exception is, where the act is not clearly illegal in itself.” I do not suppose that anyone concerned in the present case thought that what was done was illegal. It was indeed illegal in the sense of being *ultra vires*, but it has been held over and over again that the payment of money by a trustee to a *cestui que trust*,

who takes it, knowing that the payment is a breach of trust, does not constitute the trustee a tort-feasor. \* \* \*

VAUGHAN WILLIAMS, L. J. \* \* \* In my opinion, the doctrine under which a person who has made a voluntary payment under a mistake of law can not recover back the amount paid has no application here, because the money paid to the liquidator, and now sought to be recovered by those who have paid it for the defendant, was money paid under compulsion. In this state of things a doctrine applies which may be stated in a few words. Where two persons are equally liable to be sued for a sum of money, and one is sued and is compelled to pay the sum, it follows that such person will have a right over against the other, which right will be measured by the benefit the other person has received by the payment. It may sometimes be a right to indemnity and sometimes a right to contribution, but the principle is the same in either case. \* \* \*

*Appeal dismissed.*

*Note.* Compare, 1889, Sayles v. Brown, 40 Fed. Rep. 8; 1903, Gilbert v. Finch, 173 N. Y. 455, 93 Am. St. R. 623, 61 L. R. A. 807, 68 N. E. 133.

### Sec. 629. 3. Relation of officers among themselves.

See North Hudson Building Ass'n v. Childs, 82 Wis. 460, *supra*, p. 1737; Nix v. Miller, 57 Pac. Rep. 1084, *infra*, p. 1874.

See 1903, Gilbert v. Finch, 173 N. Y. 455, 93 Am. St. R. 623, 61 L. R. A. 807.

### Sec. 630. 4. Relation to creditors.

See *infra*, Creditors and officers, §§ 661-9.

### Sec. 631. 5. Relation to third parties.

(a) False warranty of authority; *ultra vires*.

#### DEXTER SAVINGS BANK v. FRIEND.<sup>1</sup>

1898. CIRCUIT COURT OF THE UNITED STATES, S. D. OHIO, W. D.  
90 Fed. Rep. 703-707.

[Suit by the bank to recover damages against Friend for falsely representing he had authority to issue notes for the Friend-Stebbins Manufacturing Company. A motion—to be treated as a demurrer—was filed, which by the second assignment asked the plaintiff to state definitely how and wherein it was damaged.]

THOMPSON, DISTRICT JUDGE. \* \* \* The second assignment of the motion is predicated upon the fact that the plaintiff is an innocent

<sup>1</sup> Statement abridged. Parts of opinion upon other points omitted.

holder of the notes, and has a right of action thereon against the Friend-Stebbins Manufacturing Company to recover the amount of the moneys mentioned therein, and that, therefore, in this action, which is one to recover damages against the defendant, Friend, for falsely representing that he had authority to sign and put the notes in circulation, the plaintiff is only entitled to recover nominal damages, unless special damages be assigned and definitely set forth in the petition. This proposition concedes the right of the plaintiff to sue the Friend-Stebbins Manufacturing Company upon the notes to recover the amount thereof, and also to sue the defendant, Friend, for damages for falsely warranting that he had authority to sign and put the notes in circulation. I doubt if this position can be maintained. In my opinion, the plaintiff is either limited to an action against the Friend-Stebbins Manufacturing Company on the notes, or has an election either to sue that company upon the notes, or the defendant, Friend, for damages, and can not pursue both remedies. If the plaintiff can recover its moneys, with interest, by an action on the notes against the company, it has no claim against the defendant, Friend; and, on the other hand, if the present action can be sustained, and the plaintiff is entitled to be made whole for the moneys expended by it in the purchase of these notes, then it has waived its right of action against the company.

The questions, therefore, for consideration upon this motion are: (1) Is the plaintiff limited to an action on the notes against the Friend-Stebbins Manufacturing Company? (2) Or has it an election between an action on the notes against the company and an action against the defendant for damages, for falsely warranting his authority to sign and put the notes in circulation? A distinction must be made between cases where there is an absolute want of authority on the part of the agent and cases where the agent has authority, but abuses it. Where the agent has authority, and where negotiable commercial paper is the subject of the transaction, an innocent holder of the paper gets just what he bargained for; but where the agent is without authority, the holder gets nothing. Where the agent is without authority, according to some of the cases, the holder has an election to sue the agent on the paper, treating it as his contract, or to sue him for damages for falsely warranting his authority to put the paper forth. But the great weight of authority is to the effect that the holder must resort to the latter remedy. The holder can not look to the principal. *Taylor v. Nostrand*, 134 N. Y. 109, 31 N. E. Rep. 246; *Trust Co. v. Floyd*, 47 Ohio St. 525, 538-541, 26 N. E. Rep. 110; *White v. Madison*, 26 N. Y. 117, 123-125. And the holder, although but an indorsee of the paper, may maintain an action for damages against the agent if the representation of authority is untrue, even though the agent's motives were good, and no fraud in fact was intended. In such cases, the representation may be regarded as made to all to whom the paper may be offered in the course of circulation. *Polhill v. Walter*, 3 Barn. & Adol. 38, 123.

But where the agent has authority to sign and put forth negotiable



commercial paper in behalf of his principal, but abuses the authority given him, if, as in this case, Friend, as the president and treasurer of the Friend-Stebbins Manufacturing Company, had authority to sign and put in circulation negotiable commercial paper in furtherance of and in the regular course of the business of the corporation, and, instead of doing that, abused the authority given him by putting forth the paper in question for the accommodation of a stranger, and the paper came into the hands of the plaintiff as an innocent holder, then the corporation is bound, and must pay the notes, and look to Friend for redress for the injury it has sustained. Here the holder has not been deceived or misled. It has got just what it expected to obtain, and can maintain an action against the corporation to compel the payment of the notes, and has no claim against Friend. The wrong involved in Friend's abuse of authority was committed against the corporation, and not against the holder of the paper. Friend, the agent, had authority to put forth business paper on behalf of the corporation, and, so far as the holder is concerned, this is the business paper of the corporation. It was intended that the holder should have a good title to the paper. It was necessary to protect the holder in order to accommodate Hargrave & Co. The representation, so far as the holder is concerned, was not untrue or false. But in view of the fact that the plaintiff got all it bargained for, and has sustained no injury, the representation, if false, is immaterial. *Bird v. Daggett*, 97 Mass. 494. Therefore, if there was no false representation to the plaintiff, and if plaintiff has a right of action on the notes against the corporation for the recovery of the amount of moneys for which they were given, it can have no right of action against Friend for damages, nominal or otherwise. It has no election, therefore, between an action on the notes against the company and an action against the defendant for damages for falsely warranting his authority to sign and put the notes in circulation, but is limited to an action on the notes against the company. \* \* \*

Petition does not state facts sufficient to constitute a cause of action.

*Note.* See, 1895, *Greenberg v. Lumber Co.*, 90 Wis. 225, 48 Am. St. Rep. 911, note 913 *infra*, p.1799; 1895, *Nunnally v. Southern Iron Co.*, 94 Tenn. 397, 28 L. R. A. 421, note; 1898, *Davenport v. Newton*, 71 Vt. 11, 42 Atl. Rep. 1087; 1898, *Houston v. Thornton*, 122 N. C. 365, 45 Am. St. Rep. 699; 1900, *Michelson v. Pierce*, 107 Wis. 85, 82 N. W. Rep. 707; 1900, *Utley v. Hill*, 155 Mo. 232, 78 Am. St. Rep. 569. See, also, following cases.

Sec. 632. Same.

(b) Torts in general.

GREENBERG, RESPONDENT, v. THE WHITCOMB LUMBER COMPANY,  
APPELLANT.  
GREENBERG, APPELLANT, v. SEMPLE, RESPONDENT.<sup>1</sup>

1895. IN THE SUPREME COURT OF WISCONSIN. 90 Wis. Rep.  
225-232, 48 Am. St. Rep. 911.

NEWMAN, J. The complaint states, in substance, that the defendant, The Whitcomb Lumber Company, is a corporation; that the defendant, Parlan Semple, was one of its officers and its general managing agent; that its business was the manufacturing of timber into firewood; that it operated, in this work, a machine which was defective and dangerous; that it knew the machine to be defective and dangerous; that the defect which rendered it dangerous was that the saw was defectively and insecurely fastened to its shaft; that the plaintiff was employed to work upon or with this machine; that he was inexperienced in such work and as to such machine, and did not know of the defect of the machine; that the defendants knew that he was so inexperienced and ignorant; that plaintiff received no instructions; that he was injured, without his fault, by reason of the defect of the machine. Fairly construed, this is the substance of the complaint. It was the duty of the defendant, The Whitcomb Lumber Company, to furnish the plaintiff a safe machine to work with, and, knowing the defect of the machine and that he was inexperienced, to instruct him of the dangers of the employment. Not to do this was negligence. The complaint states a cause of action against the defendant, The Whitcomb Lumber Company.

Whether the complaint states a cause of action against the defendant, Parlan Semple, is more complex. He was the agent or servant of The Whitcomb Lumber Company, charged with the oversight and management of its operations, and with the duty of providing a safe machine for the work in which the plaintiff was engaged. The principle is well settled that the agent or servant is responsible to third persons only for injuries which are occasioned by his misfeasance and not for those occasioned by his mere nonfeasance. Some confusion has arisen in the cases from a failure to observe clearly the distinction between nonfeasance and misfeasance. These terms are very accurately defined, and their application to questions of negligence pointed out by Judge Metcalf in *Bell v. Josselyn*, 3 Gray 309. "Nonfeasance," says the learned judge, "is the omission of an act which a person ought to do; misfeasance is the improper doing of an act which a person might lawfully do; malfeasance is the doing of an act which a person ought not to do at all." The application of these definitions to the case at bar is not difficult. It was Semple's duty to have had this machine safe. His neglect to do so was nonfeasance. But that

<sup>1</sup> Statement, except as given in the opinion, and arguments omitted.

alone would not have harmed the plaintiff if he had not set him to work upon it. To set him to work upon this defective and dangerous machine, knowing it to be dangerous, was doing improperly an act which one might lawfully do in a proper manner. It was misfeasance. Both elements, nonfeasance and misfeasance, entered into the act or fact which caused the plaintiff's damages. But the nonfeasance alone could not have produced it. The misfeasance was the efficient cause. For this the defendant Semple is responsible to the plaintiff. *Mechem Agency*, § 569, *et seq.*; 14 *Amer. & Eng. Ency. of Law* 873, and cases cited in note 4; *Wood Mast. & Serv.* (2d ed.) 667; *Osborne v. Morgan*, 130 Mass. 102.

The complaint states but a single cause of action. It is the same cause of action against both defendants, arising from the same acts of negligence—the master for the negligence of its servant; the servant for his own misfeasance. Both master and servant, being liable for the same acts of negligence, may be joined as defendants. *Wood Mast. & Serv.*, *supra*; *Wright v. Wilcox*, 19 Wend. 343; *Phelps v. Wait*, 30 N. Y. 78.

BY THE COURT. The order appealed from by The Whitcomb Lumber Company is affirmed, and the order appealed from by the plaintiff is reversed.

*Note.* See preceding case and notes, and following case.

### Sec. 633. Same.

#### (c) Negligence.

### MINNIE CAMERON, ADMINISTRATRIX, APPELLANT, V. KENYON-CONNELL COMMERCIAL COMPANY ET AL., RESPONDENTS.<sup>1</sup>

1899. IN THE SUPREME COURT OF MONTANA. . 22 Mont. Rep. 312-323, 74 Am. St. Rep. 602, 44 L. R. A. 508.

[Suit by administratrix of A. D. Cameron, against the company and its directors, for damages for the killing of Mr. Cameron, by the explosion of giant powder alleged to have been negligently kept by the corporation, with the knowledge and consent of the directors and officers. A nonsuit as to the directors as individual defendants was granted, upon which plaintiff moved for a new trial; this motion was overruled, and plaintiff appealed.]

HUNT, J. \* \* \* The record discloses these facts: The defendant corporation dealt in hardware, merchandise and powder. It owned a large frame, iron-roofed warehouse, near a railroad depot within the corporate limits of the city of Butte, where it kept its merchandise, including Hercules powder, a dangerous explosive compound of nitro-glycerine and other substances. On the night of January 15, 1895, the warehouse took fire. Plaintiff's intestate, Cameron, was the chief of the fire department of the city of Butte,

<sup>1</sup> Statement abridged. Arguments and part of opinion omitted.

and commanded the firemen who responded to the alarm. While the firemen were actually engaged in an endeavor to put the fire out, a fearful explosion occurred within the corporation's warehouse, and many persons, including Cameron, were killed. From the beginning of the year 1893 Hercules and giant powder had been kept in the warehouse. Defendants Kenyon and Connell had both been seen in or about the building during 1893, and at divers times up to the time of the explosion, Kenyon often, Connell very seldom, the other defendants never. The quantity of powder kept in the warehouse about the 1st of each month was from twenty to fifty boxes, larger quantities being stored in a powder magazine three miles out of the city.

On the day before the explosion a witness saw some seven boxes of powder, fifty pounds in each box, in the warehouse. An employe, one Orcutt, had immediate charge of the warehouse, and ordered the powder put where it was. He said that on the day of the explosion he thought there was somewhere about three to five cases of powder in the warehouse; while another witness, a mining superintendent accustomed to using powder, said he thought a ton must have exploded on the night of the fire.

Defendant Connell was president of the corporation; Kenyon was general manager. Kenyon's duties were to give attention to the corporation's business, his particular business being to look after the financial part, and ordering goods, but not to manage or control the warehouse or magazine, which were under the warehouseman Orcutt's direct charge. Neither Connell, the president, nor any of the other trustees, except Kenyon, had anything whatever to do with the actual personal management of the affairs of the corporation.

It is plain that this corporation, like many others in the commercial world, had one head—director—to whom all the other trustees gave the entire practical management of the concern.

It thus furnishes but a single instance of the common practice among business men to incorporate commercial enterprises, and, in doing so, of their trusting the entire actual management to the one director who is familiar with, and assumes the real control of, the particular business undertaken. This custom has doubtless been the outgrowth of a belief, generally correct, too, that, by incorporating mercantile or other undertakings, directors are not liable to creditors in case of business reverses, while those who associate themselves as members of a partnership are.

But, notwithstanding all this, there are various unavoidable responsibilities that attach themselves inseparably to the office of corporate directorship, which, in case of negligence or misconduct, often illustrate the risks incidental to accepting such positions of trust in a corporation and of not prudently guarding against their possible consequences.

It is a general rule that the ordinary business of a corporation is managed in the name and on behalf of the corporation by particular agents, chosen by the stockholders. These agents are the directors. For their acts, performed within the apparent scope of their author-

ity, the corporation is responsible, while, *e converso*, the corporation can act through these agents alone.

These principles are generally familiar to business men, as well as to lawyers. They control the relation of the artificial being, the corporation, to the world at large. They find their foundation in the law of agency, which makes the corporation the principal; still, they are extended, under certain conditions, far enough to inculcate the agents or directors of the corporation, notwithstanding the fact that the principal may also be liable for a wrong done. \* \* \*

(After stating that upon a motion for nonsuit, everything that the evidence tended to prove must be taken as true, and the corporation was clearly liable, proceeds:)

Hence we pass to the more direct inquiry whether the directors of the guilty corporation are also liable for Cameron's death.

As said before, the trustees manage the stock, property and concerns of a corporation (Comp. St., Fifth Div., § 450), wherefore it is difficult to see how all responsibility in this management can be avoided as long as the trustees hold their offices. Certainly, the ministerial work of a corporation may be delegated to subordinate agents, and often must be. The details of a corporation's business necessitate this, and if directors act in good faith, and with reasonable care and diligence, in appointing and supervising such inferior agents, they are not personally responsible for damages occasioned by the agents' negligence, or even crimes. (Thomp. Corp., § 4107.) But a director can not wholly escape his duty of supervision or transfer his authority to represent his principal, at least without the principal's consent, otherwise he could evade every responsibility imposed by law upon him by simply absenting himself from meetings, or by avoiding information of the acts of the other directors in expressing the will of the corporation, or by delegating an employe to act as trustee for him. Morawetz on Private Corporations, in section 536, says: "The general supervision and direction of the affairs of a corporation are especially intrusted by the shareholders to the board of directors; it is upon the personal care and attention of the directors that the shareholders depend for the success of their enterprise. It follows that authority to delegate these general powers of management can not be implied. Thus, the directors of a company have no implied authority to enter into a contract with a creditor by which the entire management of the company's affairs is placed in his control until the debt has been paid."

Third persons may hold directors liable in positive tort, upon the principle that a positive wrong done by a servant or ordinary agent must be applied to the misfeasance of directors also. (Salmon v. Richardson, 30 Conn. 360, 79 Am. Dec. 255.)

Persons having in their custody gunpowder or other instruments of danger should keep them with the utmost care. "The risk incident to dealing with fire, firearms, explosive or highly inflammable matters, corrosive or otherwise dangerous or noxious fluids, \* \* \* is accounted by the common law among those which subject the actor to strict responsibility. Sometimes the term 'consummate care' is

used to describe the amount of caution required; but it is doubtful whether even this be strong enough. At least we do not know of any English case of this kind (not falling under some recognized head of exception) where unsuccessful diligence on the defendant's part was held to exonerate him." (Webb's Pollock on Torts, p. 615.)

A company charged with an obligation of this nature can not devolve it upon another in a manner so as to exonerate the company from a liability for an injury caused to a third person by the negligent way in which the duty pertaining to the care of giant powder or other dangerous explosives may be executed. In torts, the relation of principal and agent can not relieve the wrong-doer. (*Berghoff v. McDonald*, 87 Ind. 559.)

It is unnecessary to consider the rule which relieves the master from liability for his servant's acts, where the servant does something outside of his employment—for that is not involved.

But the case does present facts to which this principal fits: that whatever the servant is intrusted by the master to do for him must be performed with a like degree of care which the law holds the master to were he acting for himself.

We apply this principle for the reason that there is a presumption that the trustees of a trading corporation know of the principal articles in which the company deals, and whether or not such articles are highly dangerous to life and property.

It is therefore the duty of the trustees of a corporation dealing in explosives to exercise such reasonable supervision over the management of their company's business as will result in the observance of the utmost care on the part of the subordinates who direct or handle the explosives. This rule grows out of "the great principle of social duty that every man, in the management of his own affairs, whether by himself or by his agents or servants, shall so conduct them as not to injure another; and if he does not, and another thereby sustains damage, he shall answer for it." (*Farwell v. B. & W. Railroad Co.*, 4 Metc. (Mass.) 49.) It is likewise their duty to avoid the creation of nuisances by their corporation, through its employes acting within the line of their duties.

Nor will inaction by itself overthrow the force of this obligation upon trustees to so control their corporation's business as to not negligently injure third persons. Along with the assumption of the duties of trusteeship go the duties of exercising reasonable care in the manner of performing those duties. This reasonable care appears not to have been exercised in this case, where the corporation, by its trustees, permitted a public nuisance to be created, and to continue, whereby, as a consequence of the act of permitting it, a third person, not in fault, has been killed.

Because directors are themselves agents, it is none the less true that they owe a common-law duty to third persons. If they violate that duty, they are responsible, whether the violation is the result of a wrongful omission or commission. (*Mechem on Agency*, § 572.) Were the rule such that wrongful commission alone meant liability,



as before indicated, directors' statutory duties to manage would be sufficiently performed by absence; and, the denser the ignorance on a director's part of the business of his concern, the more certain his exoneration from liability for the tortious acts of the company's employees. Such a rule would be unhealthy and unsound.

The liability of a director in tort is not to be avoided by his "vicarious character," where the tort of the corporation has been committed through the directors. (Nunnelly v. So. Iron Co. (Tenn. Sup.), 28 Lawy. Rep. Ann. 421, s. c. 29 S. W. Rep. 361; Bank v. Byers, 139 Mo. 627, 41 S. W. Rep. 325; Delaney v. Rochereau, 34 La. Ann. 1123.)

Relationship of contract to a corporation neither adds to nor subtracts from a man's duty to strangers to so use his own property, or that under his control, as not to injure another. Baird v. Shipman (Ill. Sup.), 7 L. R. A. 128, 23 N. E. Rep. 384; Riche's note to Nunnelly v. So. Iron Co., *supra*; Jenne v. Sutton, 43 N. J. Law 257; Mayer v. Thompson-Hutchinson Building Co. (Ala.), 28 L. R. A. 433, 16 So. Rep. 620.

Eminent judges have drawn distinctions between a trustee's liability for misfeasance, malfeasance, and nonfeasance. (Bell v. Josselyn, 3 Gray 309.) But they are of no vital importance on this appeal. Nevertheless, reasoning upon these distinctions, defendants have argued that they are liable, if at all, to the corporation only, inasmuch as the record shows nonfeasance merely, or nonexecution of the duties of their directorships. This argument seems to overlook the proposition that directors are charged with the affirmative duty of knowing something of the management of their company's business, and of exercising reasonable supervision of its management.

Management usually signifies positive, rather than negative, conduct.

As a matter of defense, it is proper to show all facts by which the jury can say whether the inaction or ignorance relied on is a sufficient excuse for the wrong done. But we have no hesitation in saying that, upon a state of facts like that before us, nonexecution which resulted in the positive act of a creation and maintenance of a continuing nuisance on account of which a third person was killed amounts, unless explained, to misfeasance upon the part of all the directors of the company, except as to Kenyon, who, it appears, *prima facie*, must have actually known of and authorized the nuisance. As to him it was malfeasance.

A director who knew nothing of the nuisance, and who could not, by exercising ordinary diligence in control, have known of it, or, generally speaking, one who, considering the situation and all the attendant circumstances, has performed his duty of taking care, is not liable, and can not be held so. In this case the defense must show this though, for a *prima facie* case is made by plaintiff.

*Reversed and remanded.*

*Note.* See note, *supra*, § 631.

## TITLE II. EXTERNAL RELATIONS.

### CHAPTER 19.

#### THE CORPORATE CREDITORS.

##### SUBDIVISION I. THE STATE AND CORPORATE CREDITORS.

###### ARTICLE I. RIGHTS OF THE STATE.

###### Sec. 634. 1. To change remedies.

###### JAMES READ ET AL. v. THE FRANKFORT BANK.

1843. IN THE SUPREME JUDICIAL COURT OF MAINE. 23 Maine  
(10 Shep.) Rep. 318-322.

[Exceptions to ruling of the court below denying plaintiff's right to recover upon certain promissory notes from the bank as indorsers.]

TENNEY, J. By the statute of March 29, 1841, ch. 139, the act incorporating the Frankfort Bank was repealed, and provision made for the appointment of receivers, who were required, when qualified to act, to demand and receive of the officers of the bank the property to the same belonging. On the 16th of April, 1841, an additional act was passed requiring all creditors, in order to entitle themselves to a distributive share of the assets, and to prevent their claim from being barred, to exhibit and prove them to the receivers on or before the first day of July, 1842.

This action was commenced and an attachment of property made previous to the repeal of the charter of the bank, and it is insisted that thereby a right became vested in the plaintiffs to proceed with the suit under the laws which were in force at the time of its commencement, and that the same can not constitutionally be affected injuriously by any act of the legislature. But if the repeal was not in contravention of the constitution, it is contended that the plaintiffs have substantially complied with the statute of the 16th of April by causing a copy of the writ to be served on the receivers on the 17th of June, 1841, a time long before that, when the claim was to have been barred, if the same had not been exhibited and proved to the receivers.

By the act of 1831, chapter 519, entitled "an act to regulate banks and banking," section 32, the legislature reserve to themselves, in cases therein named, after certain proceedings, the right to declare charters of banks forfeit and void. The Frankfort bank, incorporated after the en-

actment of this statute, was subject to its provisions, which were a part of its charter. It is not contended that the bank had not exposed itself so that its charter was properly revoked, or that all the necessary steps were not taken by the legislature agreeably to the general statute of 1831, previous to the repealing act; and in default of evidence to the contrary, it must be so presumed. Neither is it contended that the bank did not submit to the provisions of the repealing statute, acknowledged the authority of the receivers, and surrendered to them its books and its property.

After this, the creditors of the bank can not object to the constitutionality of the act dissolving the corporation, when it was done for causes which by the charter were sufficient for the purpose, and when the repeal was conclusive upon the bank. Indeed, it is not seen how *any* objection can be made by those who had no other connection therewith than that of being its creditors. Whoever entered into contracts with it exposed himself to losses which might arise from its dissolution, as he would with natural persons by their death. No security was provided in the charter, or other statute, against such an exposure to injury.

The bank having ceased to exist, excepting so far that the receivers could prosecute any suit pending in its name, and could use the name of the bank in any suit which might be necessary to enable them to collect any of the debts due to the bank, there is no party whom the plaintiff can prosecute or take judgment or execution against, unless it be in a court of equity. The bank as such has no longer the power to sue or to be sued; the receivers alone are the successors of the corporation, and they take all the property for the purposes specified in the act of repeal, and for those purposes only. Their appointment and the power given to them in nowise infringe the previously existing rights of the plaintiffs. It is by and through them that the property is to be made available in the payment of the debts against the bank. If the receivers had not been appointed, the plaintiffs could have no better prosecuted their suit than they are now able to do. The repeal of the charter has presented the obstacle to their further proceedings by dissolving the party against whom they had commenced them.

The obligation of the contract between the plaintiffs and the bank was not impaired by the repeal of its charter, but the mode of obtaining indemnity for its violation was changed. The bank was created by the legislature, and by the charter there was no provision made for the prosecution of suits against it, if that charter should be declared by the same power forfeit and void; but a mode has been provided in the repealing act, by which creditors are enabled to obtain satisfaction for their claims, to the extent of the means existing therefor. A remedy for a party may be changed or wholly taken away by the legislature without contravening the constitution of the United States. *Thayer v. Seavey*, 2 Fairf. 284; *Oriental Bank v. Freese*, 18 Me. R. 109. And such a change may constitutionally affect suits pending at the time when it is made.

Have the plaintiffs saved themselves from the operation of the limitation contained in the act of April 16, 1841? We are satisfied that they have not, though we do not perceive how a decision of that question can influence this case. For if we have taken the correct view of the effect of the act of repeal, this action can be no farther prosecuted in any court. The claim of the plaintiffs in this case is upon two notes of hand indorsed by the bank. The writ was the legal process to obtain a judgment upon this claim. In order to bring the affairs of the bank to a close within the time prescribed, the receivers were to be made satisfied of the existence of the demands and the legal title of the claimants to payment. The writ could not tend in the least to do either, and the service of the same by a copy was not such an act as to take the case from the effect of the limitation.

Non-suit confirmed.

*Note.* See *Foster v. Essex Bank*, 16 Mass. 245, *supra*, p. 895.

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**Sec. 635.** 2. To dissolve the corporation.

See *Mumma v. Potomac Company*, 8 Pet. 281, *supra*, p. 896.

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**Sec. 636.** 3. To amend corporate charters; repeal statutory liability.

See *Hawthorne v. Calef*, 2 Wall. (69 U. S.) 10, *supra*, p. 752; *Woodworth v. Bowles*, 61 Kan. 569, 60 Pac. Rep. 331, *infra*, p. 2014.

*Note.* See, also, 1884, *Webb P. & F. Co. v. Beecher*, 97 N. Y. 651; 1890, *Hill v. Merchants' Mut. Ins. Co.*, 134 U. S. 515.

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**Sec. 637.** 4. To protect, or discriminate in favor of, resident creditors.

See *Blake v. McClung*, 172 U. S. 239, *infra*, p. 2036; *Blake v. McClung*, 176 U. S. 59, *infra*, p. 2045; *Sully v. American Nat'l Bank*, 178 U. S. 289, *infra*, p. 2046; *People v. The Granite State Assn.*, 161 N. Y. 492, *infra*, p. 2050.

## ARTICLE II. RIGHTS OF CREDITORS.

**Sec. 638.** To have their security and remedy against the corporate assets substantially preserved without impairment.

See *Mumma v. Potomac R.*, 8 Peters 281, *supra* p. 896; *Read v. Frankfort Bank*, 23 Me. 318, *supra*, p. 1805; *Hawthorne v. Calef*, 2 Wall. 10, *supra*, p. 752; *Woodworth v. Bowles*, 61 Kan. 569, 60 Pac. Rep. 331, *infra*, p. 2014.

*Note.* See, 1884, *Webb P. & F. M. Co. v. Beecher*, 97 N. Y. 651; 1890, *Hill v. Merchants' Mut. Ins. Co.*, 134 U. S. 515.

## SUBDIVISION II. THE CORPORATION AND ITS CREDITORS.

## ARTICLE I. RIGHTS OF THE CORPORATION.

**Sec. 639.** 1. To manage its own business.

VIRGIL S. POND ET AL. V. FRAMINGHAM & LOWELL R. R. CO.

1881. IN THE SUPREME JUDICIAL COURT OF MASSACHUSETTS. 130  
Mass. Rep. 194, 195.

MORTON, J. This is a bill in equity, the substantial allegations of which are, that the plaintiffs are creditors of the defendant corporation; that the corporation is insolvent; that all its property is mortgaged to trustees for the benefit of one class of creditors; that it owes large amounts to other creditors, one of whom has attached all its property; that it is about to execute a lease to said attaching creditor for the term of nine hundred and ninety-nine years, at a rental which will not pay the interest upon its indebtedness, and that the execution of said lease would be injurious to the interest of its creditors and stockholders. The prayer is for an injunction to restrain the defendant from further prosecuting its business, and for the appointment of receivers.

There is no statute giving this court equity jurisdiction in such a case as this, and the bill does not state a case within the general equity powers of a court of chancery. As is stated in *Treadwell v. Salisbury Manuf. Co.*, 7 Gray 393, "It is too well settled to admit of question, that a court of chancery has no peculiar jurisdiction over corporations, to restrain them in the exercise of their powers, or control their action, or prevent them from violating their charter, in cases where there is no fraud or breach of trust alleged as the foundation of the claim for equitable relief."

The plaintiffs can not maintain this bill, unless upon the ground that any creditor can maintain a bill in equity against an individual debtor upon like allegations. But there is no allegation of fraud or

breach of trust, or any other ground of jurisdiction, which brings the case within the general equity powers of a court of chancery. The bill is an attempt by a creditor to restrain his debtor from making what is alleged to be an improvident contract. The rights of the parties are governed by the rules of the common law. The plaintiffs as creditors might, by an attachment, have obtained security which would take precedence of the contemplated lease; but if they could not, the court has no power to restrain the debtor from making a disposition of his property which is permitted by the common law, unless fraud or breach of trust is alleged and shown.

The allegation that the defendant corporation is insolvent does not aid the plaintiffs. In the absence of any statute giving the power, this court has no authority to act as a court of insolvency for the liquidation of the affairs of an insolvent railroad corporation.

*Decree dismissing the bill affirmed.*

*Note.* See, 1874, *Barr v. Bartram & F. Mfg. Co.*, 41 Conn. 506; 1882, *Swenson v. Exchange, etc., Bank*, 9 Lea (Tenn.) 713.

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Sec. 640. Same. 2. To dispose of its property.

GRAHAM v. RAILROAD COMPANY.<sup>1</sup>

1880. IN THE SUPREME COURT OF THE UNITED STATES. 102 U. S. Rep. 148-161.

MR. JUSTICE BRADLEY. In September, 1855, the La Crosse and Milwaukee Railroad Company, not being at that time, so far as appears, indebted in any considerable amount, sold certain lands in the city of Milwaukee not then wanted for railroad purposes to Charles D. Nash, for the sum of \$25,000. The officers of the company who took a leading part in negotiating the sale are charged to have been interested in the purchase, and to have furnished Nash the means for effecting it. At all events, shortly after it was made, Nash conveyed the property, for the original consideration, to Moses Kneeland, one of the officers referred to, and Kneeland, retaining one third part, subsequently conveyed the other two third parts to Ludington and Kilbourn, they all being directors of the company, and members of the executive committee. The company itself never questioned the fairness of this transaction; on the contrary, the sale was subsequently (in March, 1858) expressly confirmed by the board of directors, and a further quitclaim deed executed by the company in confirmation thereof. In September and November, 1858, the appellants recovered two judgments against the company for indebtedness on contract, arising after the sale of the lands, and issued executions thereon, un-

<sup>1</sup> Statement sufficiently given in the opinion, part of the latter being omitted.



der which levies were made on said lands, as lands of the company. In January, 1860, the appellants, having sued on these judgments in the United States court, recovered a second judgment for upwards of \$40,000, issued execution thereon, and made another levy on the lands. Being unwilling to attempt a sale under their said execution in consequence of the deeds for the lands being recorded, the appellants, in June, 1860, filed the bill in this case against Kneeland, Kilbourn, Ludington, and the railroad company, setting forth their said judgments, executions, and levies, stating the fact of the said sale to Nash and his conveyance to Kneeland, and the latter's conveyance to the other parties; alleging that the transaction was a fraud against the corporation and its creditors, and complaining that the said conveyances of the lands were a cloud upon their right to sell the lands under execution, and an impediment in the way of the execution of their writ of *fiery facias*; and prayed that the lands might be decreed subject to the lien of their judgment; that they might be decreed to be authorized to sell the same, or so much as might be necessary for the purpose of satisfying their judgment; and that Kneeland, Kilbourn and Ludington might join in the conveyance, and might be restrained from claiming the land; and that the conveyance to them might be declared null and void. The bill, amongst other things, averred that the lands were sold to Nash for much less than their real value; but it contained no allegation that the company was insolvent, or that it had not other assets available under an execution; nor was any offer made to repay the consideration which the purchaser had given for the lands.

[Answers were put in averring the lands were sold in good faith; that the title was embarrassed; that the lands were worth no more than \$25,000; that they had been offered in the market for sale without success; that after Nash purchased and investigated the title he asked to be relieved from the purchase. The proofs showed substantially these facts, and that the company had confirmed the sale.]

The main question is, whether the sale to Nash, made before the railroad company became indebted to the appellants, and when, for all that appears, it was perfectly solvent, even though made for the use and benefit of the officers referred to, can be set aside at the instance of the complainants, for the purpose of subjecting the lands to sale under their execution. And this question, we think, must be answered in the negative.

It is a well-settled rule of law that if an individual, being solvent at the time, without any actual intent to defraud creditors, disposes of property for an inadequate consideration, or even makes a voluntary conveyance of it, subsequent creditors can not question the transaction. They are not injured. They gave credit to the debtor in the status which he had after the voluntary conveyance was made.

The authorities on this subject are fully collected in the notes to *Sexton v. Wheaton* (1 Am. L. Cas. 1), and in the opinion of Mr. Chief Justice Marshall in that case; and the general doctrine is affirmed in *Mattingly v. Nye*, 8 Wall. 370.

It is true that if a debtor dispose of his property with intent to de-

fraud those to whom he expects to become immediately or soon indebted, this may be a fraud against them, which they may have a right to unravel. But that is a special case to which the present bears no resemblance. It is not pretended that the railroad company disposed of the property in question for the purpose of defrauding creditors, much less for the purpose of defrauding those who afterwards in due course of business might become its creditors.

But it is contended that this is a case in which the debtor corporation was defrauded of its property, and that as the company had a right of proceeding for its recovery, any of its judgment and execution creditors have an equal right; that it is a property right, and one that inures to the benefit of creditors.

Conceding that creditors who were such when the fraudulent procurement of the debtor's property occurred—and cases to that effect have been cited—the question still remains whether, the debtor being unwilling to disturb the transaction, subsequent creditors have such an interest that they can reach the property for the satisfaction of their debts. We doubt whether any case, going as far as this, can be found. No such case has been cited in the argument. Dicta of judges to that effect may undoubtedly be produced, but they are not supported by the facts of the cases under consideration.

It seems clear that subsequent creditors have no better right than subsequent purchasers to question a previous transaction in which the debtor's property was obtained from him by fraud, which he has acquiesced in, and which he has manifested no desire to disturb. Yet, in such a case, subsequent purchasers have no such right. In *French v. Shotwell* (5 Johns. (N. Y.) Ch. 555), Chancellor Kent decided, upon full consideration, that when a party to a judgment, entered upon a warrant of attorney, voluntarily waives his defense or remedy on the ground of fraud or usury, and releases the other party, a subsequent purchaser under him, with notice of the judgment, will not be allowed to impeach it, or to investigate the merits of the original transaction between the original parties, and he dismissed a bill filed by the subsequent purchaser for relief in such a case. \* \* \*

This decision of Chancellor Kent was afterwards nearly unanimously affirmed by the court of errors. 20 Johns. (N. Y.) 668.

When the question of the right of a creditor to set aside a conveyance procured from the debtor by fraud first came before the courts in England, it was held that the debtor's own right was merely the right to file a bill in equity against the fraudulent grantee adversely; and, if he did not see fit to take such a proceeding, his creditor had no such privity with the transaction as to enable him to obtain relief, even though the debtor should assign his supposed right to the creditor; that the transaction savored of champerty, and was opposed, at least, to the spirit of the law against champerty and maintenance. This was the substance of the decision by the court of exchequer in 1835, in *Prosser v. Edmonds*, 1 Y. & C. 481. \* \* \*

[Quoting from this case, and also from *Crocker v. Bellangee et al.*, 6 Wis. 645; *Milwaukee & St. P. R. Co. v. M. & M. R. Co.*, 20 Wis.

174; also commenting upon and showing that *Dickinson v. Burrell*, L. R. 1 Eq. 337, and *McMahon v. Allen*, 35 N. Y. 403, had not overruled *Prosser v. Edmonds*, proceeds:]

The principle that subsequent creditors can not question a voluntary or fraudulent disposition of property by their debtor, not intended as a fraud against them, is especially applicable in cases of constructive fraud, like that charged in the present bill. Suppose it be true that the purchase of the lands in question by or for the benefit of officers of the company actively concerned in the transaction could be set aside at the instance of the company as a constructive fraud, yet, if there was no actual fraud, if the company received full consideration for the property sold, how can it be said that subsequent creditors of the company are injured?

In the present case we are satisfied from the evidence that the property was sold for its fair value at the time, and that no actual loss accrued to the railroad company's estate.

It would be unjust, and a great hardship, therefore, on the mere ground of the constructive fraud, to allow creditors who had no interest at the time to seize and dispose of the property sold.

It is contended, however, by the appellant that a corporation debtor does not stand on the same footing as an individual debtor; that, whilst the latter has supreme dominion over his own property, a corporation is a mere trustee, holding its property for the benefit of its stockholders and creditors, and that if it fail to pursue its rights against third persons, whether arising out of fraud or otherwise, it is a breach of trust, and creditors may come into equity to compel an enforcement of the corporate duty. This, as we understand, is the substance of the position taken.

We do not concur in this view. It is at war with the notions which we derive from the English law with regard to the nature of corporate bodies. A corporation is a distinct entity. Its affairs are necessarily managed by officers and agents, it is true, but, in law, it is as distinct a being as an individual is, and is entitled to hold property (if not contrary to its charter) as absolutely as an individual can hold it. Its estate is the same; its interest is the same; its possession is the same. Its stockholders may call the officers to account, and may prevent any malversation of funds, or fraudulent disposal of property on their part. But that is done in the exercise of their corporate rights, not adverse to the corporate interests, but coincident with them.

When a corporation becomes insolvent, it is so far civilly dead that its property may be administered as a trust fund for the benefit of its stockholders and creditors. A court of equity, at the instance of the proper parties, will then make those funds trust funds; which, in other circumstances, are as much the absolute property of the corporation as any man's property is his. We see no reason why the disposal by a corporation of any of its property should be questioned by subsequent creditors of the corporation any more than a like disposal by an

individual of his property should be so. The same principles of law apply to each.

We think that the present bill can not be maintained.

*Decree affirmed.*

*Note.* See next case. Also, *accord*: 1897, Shoemaker v. Lumber Co., 97 Wis. 585; 1898, Smith-Dunnick L. Co. v. Teague, 119 Ala. 385, 24 So. Rep. 4; 1899, In re Nat'l Bank of Wales, 68 L. J. Ch. 634, 81 L. T. R. (N. S.) 363; 1899, Dykman v. Keeney, 160 N. Y. 677; 1899, McDonald v. Williams, 174 U. S. 397, *infra*, p.1981; 1899, Texas Consol. Comp. & M. Assn. v. Storrow, 92 Fed. Rep. 5, 34 C. C. A. 182; 1900, Hamilton v. Menominee F. Q. Co., 106 Wis. 352, 81 N. W. Rep. 876.

As to effect of selling out to another corporation, upon creditors' rights, see, 1890, Montgomery Web Co. v. Dienelt, 133 Pa. St. 585, 19 Am. St. Rep. 663; 1896, Austin v. Tecumseh Nat'l Bank, 49 Neb. 412, 59 Am. St. Rep. 543; 1896, Lebeck v. Fort Payne Bank, 115 Ala. 447, 67 Am. St. Rep. 51; 1897, Grenell v. Gas Co., 112 Mich. 70; 1898, Sprague v. National Bank, 172 Ill. 149, 64 Am. St. Rep. 17; 1900, Andres v. Morgan, 62 Ohio St. 236, 78 Am. St. Rep. 712.

As to sales and reorganizations, see, 1898, Sprague v. National Bank, 172 Ill. 149, 64 Am. St. Rep. 17; 1900, National Foundry, etc., v. Oconto City, etc., 105 Wis. 48, 81 N. W. Rep. 125.

Corporation may also, through its board of directors, make an assignment for the benefit of its creditors: 1897, Boynton v. Roe, 114 Mich. 401; 1898, Calumet Paper Co. v. Haskell Show Ptg. Co., 144 Mo. 331, 66 Am. St. Rep. 425.

## Sec. 641. Same.

### MILLS v. NORTHERN RAILWAY OF BUENOS AYRES COMPANY.<sup>1</sup>

1870. IN CHANCERY APPEALS. L. R. 5 Ch. App. Cas. 621-632.

[Appeal from order of the vice-chancellor granting an injunction. Plaintiffs were the executors of one member, and trustees in assignment of the other member of a firm of contractors who had constructed part of the railway, for which they claimed there were yet about £65,000 due and unpaid. This was disputed by the company. In 1870 the directors of the company issued a report showing about £33,000 net profit, leaving, after allowing certain claims, £17,000, which they advised to be paid toward discharging arrears of dividends due to guaranteed preferred shareholders, in 1867. They also advised that, inasmuch as it would take some time to pay these arrears of dividends out of accumulations, and constant improvements and extensions were being made out of earnings, that these should be treated as payment on capital to the extent of £10,000, and £20,000 should be raised by issuing 6 per cent. debentures, and the dividends be paid. This plan was adopted, and over £16,000 were paid as dividends. Plaintiffs objected to this as amounting to an increase of the liabilities of the company, in order to borrow money to distribute among shareholders under the guise of revenue. An injunction was asked to prevent the carrying out of this scheme, and was granted by the vice-chancellor, and an appeal was taken.]

<sup>1</sup> Statement abridged. Only part of opinion relating to the one point given.

LORD HATHERLEY, L. C. The Vice-Chancellor appears to have formed his judgment in this case, partly at least, upon the view which he took that one of the plaintiffs, Mr. Mills, was a shareholder in the company, and therefore had a right to interfere. But, so far as the case rests on the simple fact of the plaintiffs being creditors of the company, it seems to me hardly capable of argument. Work is done for a limited company; no engagement is taken from them by way of security; no debenture or mortgage is granted by them; but the work is done simply on the credit of the company. The only remedy for a creditor in that case is to obtain his judgment and to take out execution; or it may be that he may have a power, if the case warrants it, of applying to wind up the company. But it is wholly unprecedented for a mere creditor to say, "Certain transactions are taking place within the company, and dividends are being paid to shareholders which they are not entitled to receive, and therefore I am entitled to come here and examine the company's deed, to see whether or not they are doing what is *ultra vires*, and to interfere in order that, as by a bill *quia timet*, I may keep the assets in a proper state of security for the payment of my debt whensoever the time arrives for its payment."

The case must have occurred, of course, many years ago, before joint stock companies were so abundant, but certainly within the last twenty or thirty years the money due to creditors must have been many millions, and the number of creditors must have been many thousands; yet I have never before heard—and I asked in vain for any such precedent—of any attempt on the part of a creditor to file a bill of this description against a company, claiming the interference of this court on the ground that he, having no interest in the company, except the mere fact of being a creditor, is about to be defrauded by reason of their making away with their assets. It would be a fearful authority for this court to assume, for it would be called on to interfere with the concerns of almost every company in the kingdom against which a creditor might suppose that he had demands, which he had not established in a court of justice, but which he was about to proceed to establish. If there is this power in any case, of course it would apply not only to the raising of money by debentures and to paying shareholders, but it would extend to an interference in every possible way with the dealings of the company. \* \* \*

*Reversed.*

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Sec. 642. Same. 3. To accept amendments.

See Hawthorne v. Calef, 2 Wall. 10, *supra*, p. 752; Ireland v. The Palestine, etc., Tp. Co., 19 O. S. 369, *supra*, p. 757; also, §§ 466-473.

**Sec. 643. Same. 4. To surrender the charter.**

See *supra*, §§ 244–246, and *Slee v. Bloom*, 5 John Ch. 366, 19 Johns. 456, *supra*, p. 881; *Louisville Banking Co. v. Eisenman*, 94 Ky. 83, *supra*, p. 887.

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**Sec. 644. Same. 5. To consolidate with other corporations.**

See *supra*, §§ 282–287.

*Note.* See, also, note, *supra*, p. 1003.

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**Sec. 645. 6. Right to prefer creditors. Theories:**  
(a) Can.

CATLIN v. THE EAGLE BANK OF NEW HAVEN AND OTHERS.<sup>1</sup>

1826. IN THE SUPREME COURT OF ERRORS OF CONNECTICUT. 6  
Conn. Rep. 233–245.

This was a bill in chancery.

The Eagle Bank is a corporation, established, by an act of the legislature, in October, 1811, for banking purposes, with the usual powers of such an institution, the charter being, at all times, subject to alteration, amendment or revocation by the general assembly. The plaintiff is a creditor of this corporation to the amount of between \$90,000 and \$100,000. The bank, on the 15th of September, 1825, failed, and was in fact insolvent. Among its creditors was The Savings Bank of New Haven, a corporation, empowered to receive deposits from individuals, for safekeeping and management, and obliged to pay the depositors the interest or profits that should accrue. This institution had deposited with the Eagle Bank, at an interest of 4 per cent. and to be returned on demand, all the money, which it had received, in small sums, from a great multitude of depositors, amounting to between \$80,000 and \$90,000. In payment and security of this demand, the directors of the Eagle Bank, after its actual insolvency, mortgaged to the savings bank real estate worth about \$20,000, paid to Samuel J. Hitchcock, Esq., secretary of the savings bank, about \$15,000 in money, and assigned to him sundry negotiable promissory notes to the amount of about \$52,000. The bill prayed that these conveyances might be set aside, and that all the funds of the Eagle Bank, at the time of its failure, might be equitably distributed among its creditors, in proportion to their respective claims.

The case was reserved for the advice of this court.

<sup>1</sup> Arguments omitted.



HOSMER, CH. J. It is an undoubted principle that the powers of a corporation are solely derived from its charter, which is the law of its nature; and that it is invested with such powers only as are expressly delegated, or which are necessary to carry the express delegations into effect. *The New York Firemen Insurance Company v. Ely et al.*, 5 Conn. Rep. 560. By the act of incorporation the Eagle Bank had authority to purchase, hold and convey property, with the usual banking powers superadded; and the directors of the bank were authorized to dispose of and manage its moneys, credits and property, and to regulate its concerns in all cases not especially provided for. To this general grant, in relation to the rights, privileges and duration of the bank, there is neither exception nor limitation, save that the charter is alterable, amendable, and revocable, at the pleasure of the legislature. It results, undeniably, that the rights, powers and duties of the bank, so far as they depend on the act of incorporation, remain unchanged, until it is revoked, and independent of its actual solvency or insolvency. The general laws of the land, or the principles which guide this court, as a court of chancery, may make a difference on this subject; but setting aside these considerations, and admitting the operation of the charter exclusively, the bank is authorized to exercise the same powers, at all times, without reference to its condition.

Whether the directors of the corporation, after it has become actually insolvent, can make payment or give security to one of its creditors and leave another unpaid and without security, is the general question to be determined. It has been contended, in behalf of the plaintiff, with no inconsiderable ingenuity, that the legislature intended to render the corporation at all times a trustee for the creditors. This suggestion is too unfounded, and too destitute of practical importance, to be admitted or discussed. Such a principle, during the solvency of the bank, must be dormant and useless; and neither the charter nor the nature of the case furnishes any warrant for the supposition.

If the corporation, so far as regards its right to manage and dispose of its property, has power analogous with that which is vested in an individual, the plaintiff's bill is wholly destitute of merits. An individual debtor, who is actually insolvent, may prefer one creditor to another, unless in certain cases, under the bankrupt laws; and to do this, as was said by Lord Kenyon, is neither illegal nor immoral. We have no bankrupt system to control the acts of the insolvent merchant; and in the absence of all legal liens he may prefer a creditor, if the act is done in good faith. To discuss the reasons of the rule is unnecessary. It is sufficient to say to those who are not disposed to unsettle foundations, that it is firmly and uniformly established, both at law and in chancery. *Estwick v. Caillaud*, 5 Term Rep. 420; *Nunn v. Wilsmore*, 8 Term Rep. 521; *Hopkins v. Gray*, 7 Mod. Rep. 139; *Meux et al. v. Howell et al.*, 4 East 1; *McMenomy et al. v. Ferrers*, 3 Johns. Rep. 84; *Willes et al. v. Ferris*, 5 Johns. Rep. 344; *Small v. Oudley*, 2 P. Wms. 427; *Cock v. Good-*

fellow, 10 Mod. Rep. 489; Phœnix v. Assignees of Ingraham, 5 Johns. Rep. 412, 426, 427; Hendrick v. Robinson, 2 Johns. Ch. Rep. 283. The same rule is equally applicable to partners; and what is a banking corporation, in the essence, but a partnership authorized by a special act of the legislature? Gow on Part., 234. It is *an artificial person*; and this denomination is given to it by reason of its resemblance to a natural person, in respect of its powers, rights and legal duties. It is difficult for me to conceive, where no restraint is interposed, in a charter of incorporation, on what ground the general authority delegated is subjected to exceptions, or fettered by restrictions, from which an individual and a mercantile company are free. And this difficulty is much increased, as no case intimating this diversity between corporations and individuals has been cited, nor can be found by my utmost researches. Where no legal lien has been obtained it is a reasonable supposition that the relation of creditor and debtor must, in all cases, infer the same consequences; and that where the same mischief exists, there is the same law. The cases of an individual and of a corporation, in the matter under discussion, it appears to me, are not merely analogous, but identical; and I discern no reason for the slightest difference between them. There exists no doubt that there have been many instances of actually insolvent corporations where certain creditors have been preferred to others; and the perfect silence until now, on the subject of this fancied diversity, is powerful to show what has been the universal opinion.

It, however, has been insisted for the plaintiff, that on the actual insolvency of the bank the corporation were the trustees of the creditors; and if this be true, the latter become the *cestui que trusts* of all the corporate estate. The consequence, on this supposition, would be that all persons coming into possession of the bank property, with notice of the trust, must be considered as trustees. Daniels v. Davison, 16 Ves. Jun. 249; Moore v. Butler, 1 Scho. & Lef. 262. No express trust was created on the happening of the bank's insolvency, but the charter, on every fair principle of construction, conferred on the corporation the entire control of its property, as well after as before this event.

It, however, has been imagined that the trusts arose by operation of law. I inquire of what law? No principle, or case, or analogy has been referred to that supports the proposition, nor am I capable of conceiving any. The insolvent banking corporation is just as much a trustee of the creditors, and no more, as the insolvent individual is the trustee of his creditors. The relation of creditor and debtor exists in both cases, but from this relation no trust arises. Undoubtedly, in all cases of actual insolvency, the creditor would derive security from this doctrine, and often great losses might be prevented. But the interest of the insolvent person is not to be entirely disregarded. His creditor has voluntarily become such, with full knowledge that his security must very much depend on the integrity of his debtor. With open eyes he has given credit, and the public charter of the cor-

poration has instructed him in all the powers and rights of the corporation.

Now, it would be a very harsh and inequitable doctrine, but on the plaintiff's claim it is inevitable, that the moment a banking institution is unable to pay all its debts, the directors of the bank may not issue a bank bill, dispose of bank property, make payment of a single debt, or perform one bank operation. May not an individual, or mercantile company, under the same circumstances, proceed in the usual train of business? This is not disputed. It is the law of chancery, that they may prefer one creditor to another; and this, on a principle of analogy, refutes, entirely, the supposition of a trust in this case. The novelty and unsoundness of the plaintiff's claim are such that it is difficult to support or even to oppose it, without taking leave of every established principle and beating the air. That the directors of the Eagle Bank are trustees, I admit; but they are the trustees of the stockholders. The stockholders are the *cestui que trusts*, and the charge of breach of trust must come from them. *The Attorney-General v. The Utica Insurance Co.*, 2 Johns. Ch. Rep. 371, 385.

The funds of the corporation, after its insolvency, have been called *equitable assets*; but the name was wholly misapplied. Equitable assets, generally speaking, are such as the debtor has made subject to his debts generally, that would not thus be subjected without his act (2 Fonb. Eq. 402, n. d.); and which can be reached only by the aid of a court of equity. They are divisible among the creditors, as all property is, when placed under the jurisdiction of a court of chancery, *pari passu*, in ratable proportions. *Riggs et al. v. Murray et al.*, 2 Johns. Ch. Rep. 565, 577. But they must be assets or they can not be equitable assets; and this term does not express the nature of property, in the hands of an individual, partnership or corporation actually insolvent. On the estate of such persons there is no equitable lien to interrupt the free progress of their business or prevent the fair disposition of their property. \* \* \*

There is a class of cases in which chancery has exercised a control over corporations in relation to breaches of trust, but in such cases the jurisdiction has alone been extended to *charitable* institutions. *Shaw v. Cunliffe*, 4 Bro. Ch. Rep. 145; *Ball v. Montgomery*, 2 Ves. Jun. 199. \* \* \*

On the other hand, in *The Attorney-General v. The Corporation of Carmarthen*, Coop. Eq. Rep. 30, the jurisdiction was denied, by the chancellor, in the very case of a misapplication of funds. And in *The Mayor and Commonalty of Colchester v. Lowton*, 1 Ves. & Bea. 226, Lord Eldon held that there was no instance of a trust attaching, upon the ground of a misapplication of funds by corporations, except in the case of corporations holding to *charitable* uses.

From this discussion it is unquestionable that the jurisdiction of chancery does not extend to the disposal of the corporation estate or funds of the Eagle Bank. More time has been occupied in the examination of the principle than perhaps can be justified, as it has no application to the case before us. The bank has, in no proper

sense, misapplied its funds. It has done what it had a right to do, and what is uncontrollable by this court; that is, it has preferred to pay and secure the claim of what was considered a meritorious creditor. Of its creditors, the corporation was not a trustee; they had no lien upon its funds, and no case is made out entitling the plaintiff to relief, or showing any jurisdiction exerciseable by this court.

The plaintiff's bill must be dismissed.

Brainard and Lanman, JJ., were of the same opinion.

Peters, J., being interested in the question, and Daggett, J., having been of counsel in the cause, gave no opinion.

Bill to be dismissed.

*Note. Accord:* 1879, *Smith v. Skeary*, 47 Conn. 47; 1890, *Rollins v. Shaver Co.*, 80 Iowa 380, 33 Am. & Eng. C. C. 291; 1892, *Bank of Montreal v. Potts Co.*, 90 Mich. 345, 38 Am. & Eng. C. C. 60; 1893, *Brown v. Grand Rapids Furniture Co.*, 58 Fed. Rep. 286; 1894, *Worthen v. Griffith*, 59 Ark. 562, 47 Am. & Eng. C. C. 258; 1895, *Tradesman Pub. Co. v. Knoxville, etc., Co.*, 95 Tenn. 634, 49 Am. St. Rep. 943 (can so long as the corporation is a "going concern"); 1895, *Waggoner Co. v. Ziegler Co.*, 128 Mo. 473, 31 S. W. Rep. 28; 1895, *Chicago, etc., Co. v. Fowler*, 55 Kan. 17, 39 Pac. Rep. 727; 1895, *Bank v. Dove-tail, etc., Co.*, 143 Ind. 550, 52 Am. St. Rep. 435; 1896, *Ford v. Hill*, 92 Wis. 188, 53 Am. St. Rep. 902 (by confession of judgment); 1896, *Ames v. Heslet*, 19 Mont. 188, 61 Am. St. Rep. 496; 1898, *Burchinell v. Bennett*, 10 Colo. C. A. 150, 8 Am. & Eng. C. C. (N. S.) 289; 1898, *National Bank v. Allen*, 90 Fed. Rep. 545; 1898, *M. A. Seeds Dry Plate Co. v. Heyn, etc., Co.*, 57 Neb. 214, 77 N. W. Rep. 660; 1898, *Burnham H. M. & Co. v. McCormick*, 18 Utah 42, 55 Pac. Rep. 77; 1899, *First National Bank v. Garretson*, 107 Iowa 196, 77 N. W. Rep. 856; 1899, *Grand De Tour Plow Co. v. Rude Bros., etc., Co.*, 60 Kan. 145, 55 Pac. Rep. 848; 1899, *Jefferson Co. National Bank v. Townley*, 159 N. Y. 490; 1900, *Binder v. McDonald*, 106 Wis. 332, 82 N. W. Rep. 156 (national bankrupt law).

## Sec. 646. Same.

(b) Can not after insolvency.

### ROUSE, TRUSTEE, v. MERCHANTS' NATIONAL BANK.<sup>1</sup>

1889. IN THE SUPREME COURT OF OHIO. 46 Ohio St. Rep. 493-510, 15 Am. St. Rep. 644.

(Error to the superior court; this court, among other things, found as follows:)

"That on the 23d day of June, 1884, the T. J. Nottingham Manufacturing and Supply Company, defendant, being insolvent, resolved to make a general assignment of its property for the benefit of its creditors, and resolved to give a mortgage on the same property to the plaintiff, and other mortgages to other creditors, which mortgages should have preference over the assignment, and appointed F. W. Browne assignee.

"The deed of assignment was executed and delivered to the said

<sup>1</sup> Statement abridged; arguments and part of opinion omitted.

F. W. Browne, who drew all the instruments and acted as attorney for the company in the whole matter as well as assignee, on the 24th of June. Before the execution of the assignment, the mortgage was drawn, but a blank was left therein for the insertion of the amount secured by it. Next day, the 25th of June, the mortgage was completed and executed, and immediately thereafter the other mortgages were completed and executed, the whole being done at one sitting. \* \* \*

"On the 25th of June, the completed mortgage was filed in the recorder's office of Hamilton county, where chattel mortgages executed in Cincinnati by residents thereof are required by law to be filed, and on the same day, an hour or two later, the assignment was filed with the judge of the probate court.

"The amount due the plaintiff on the first day of this term, secured by said mortgage, is \$6,542.41; F. W. Browne, assignee, was removed, and George L. Rouse, defendant, was appointed trustee in his place. The property has been sold, and the proceeds are in the hands of said trustee. The plaintiff presented his claim to said trustee, and demanded its allowance and payment, all of which the said trustee refused.

"As conclusion of law the court finds that the mortgage is a valid instrument, and has preference over the assignment, and the plaintiff is entitled to the payment thereof from the proceeds of the mortgaged property.

"To all of which findings the defendant then and there excepted."

\* \* \*

WILLIAMS, J. The general question for decision in this case is, whether a corporation for profit, organized under the laws of this state, can, in the disposition of the corporate property, after it has become insolvent, and ceased to further prosecute the objects for which it was created, prefer some of its creditors over others.

The claim of the plaintiff in error is, that when the corporation becomes insolvent and ceases to carry on business, its property and assets constitute a trust fund for the benefit of its creditors, and the directors in possession of the corporate property, being trustees for all the creditors, can not lawfully dispose of it otherwise than for the equal benefit of all the corporate creditors. The defendant in error, on the other hand, contends that when not restricted by the law of their creation, or prevented by the operation of some bankrupt or insolvent law, insolvent corporations may, the same as natural persons, make preferences among their creditors.

Decisions of courts will be found maintaining each of these diverse positions. The precise question has not been decided in this state, and in view of the conflict of authority elsewhere, we are at liberty to adopt that rule which best harmonizes with the policy and legislation of the state, rests upon the sounder reason, as we conceive it to be, and coincides with our sense of justice and right.

The right of the individual debtor to prefer one creditor to another, though at the time insolvent, rests upon his complete dominion over, and consequent unrestricted power of disposition of his property.

And the cases which hold that insolvent corporations are entitled to make preferences among their creditors, attribute to them the same unlimited control over their property that is possessed by individuals over theirs. In *Catlin v. Eagle Bank of New Haven*, 6 Conn. 233, which is the leading case in this country maintaining the right of an insolvent corporation to prefer one or more of its creditors over others, the decision is distinctly placed upon the ground that the particular corporation was invested with the control and power to dispose of the corporate property, as fully and to the same extent that natural persons have with respect to their property. \* \* \*

(Quoting from the case.)

We have not the charter of the corporation in question in that case before us, but we assume that the learned judge was correct in saying that by every fair construction it conferred upon the corporation the entire control of its property after its insolvency. If so, no fault need be found with his conclusion, that it might, like any individual, prefer some of its creditors over others.

Corporations generally do not possess such amplified powers, and especially those created under the laws of this state. In this state corporations have not the same powers and capacities as natural persons, but are authorized for specified and defined purposes. They are clothed with those attributes only with which the law under which they are created invests them, and can exercise no powers not expressly conferred, or necessary to carry into effect those in terms granted.

Since the constitution of 1851, it has been the settled policy of this state to afford adequate protection to the creditors of corporations. That constitution contains the provision that "dues from corporations shall be secured by such individual liability of the stockholders and other means as may be prescribed by law, but in all cases each stockholder shall be liable, over and above the stock by him or her owned, and any amount unpaid thereon, to a further sum, at least equal in amount to such stock." Legislation, under this constitution, has been shaped to fully effectuate the constitutional guarantee. All corporations organized for profit are required to have a capital stock, 50 per cent. of which must be subscribed, and at least 10 per cent. paid in, before the organization can be effected, and the stockholders are made liable, in addition to their stock, to an amount equal to the stock held by them, to secure the payment of the debts of the corporation. This liability, it has uniformly been held by this court, is a security exclusively for the benefit of the creditors of the corporation, over which the corporation has no control; and, moreover, the security is for the equal benefit of all the creditors. The suit to enforce it must be by all the creditors, and against all the stockholders, and no creditor can acquire priority over the others with respect to it. And, while power is conferred on corporations to reduce their capital stock, it is expressly provided that the rights of creditors shall not be affected, nor in any way impaired.

The corporate powers, business and property of the corporation



must be exercised, conducted and controlled by a board of directors, all of whom must be stockholders; and, as a still further guarantee for creditors, the powers of corporations over their property, its use and disposition, are so circumscribed by positive statute that no corporation can employ its stock, means, assets or other property, directly or indirectly, for any other purpose whatever than to accomplish the legitimate objects of its creation. The extent of the powers expressly conferred on them are, to sue and be sued, contract and be contracted with, and acquire and convey such real and personal estate as may be necessary or convenient to carry into effect the objects of the incorporation, to make and use a common seal, and do all needful acts to carry into effect the objects for which they are created. It is obvious that the corporate property can not with propriety be said to be owned by the corporation, in the sense of ownership as applied to property belonging to natural persons. The latter may without restriction acquire and dispose of property for any lawful purpose, while both the power of acquisition and disposition of the former are limited to the special objects already mentioned. The corporate property is in reality a fund set apart to be used only in the attainment of the objects for which the corporation was created, and it can not lawfully be diverted to any other purpose. As soon as acquired it becomes impressed with the character of a trust fund for that purpose, and the shareholder or creditor may interpose to prevent its diversion from the objects of the incorporation injurious to him. Taylor on Private Corporations, § 34.

The custody and control of the property, and the management of the business of the corporation, are confided to a board of directors chosen by the shareholders. Into the hands of these officers, through whom alone corporations can act, the shareholders surrender their funds and entrust the management of the affairs and property of the corporation to them. A relation of trust and confidence, therefore, arises between the stockholders and directors of a corporation, out of which grow the duties of the latter, to so administer the trust as will best promote the interests of the former, to pay them their appropriate dividends from time to time, and upon the termination of the corporation to distribute to them their respective shares of the corporate property after the payment of its debts and liabilities. These duties are eminently of a fiduciary nature. It is now so well established as to be no longer a subject of controversy, that the relation of trustee and *cestui que trust* subsists between the directors and shareholders. And, since the directors, as such trustees, represent and act for all the shareholders, they can not lawfully favor any particular shareholder or class of shareholders, but every authority and power possessed by them must be exercised for the benefit of all alike. Otherwise no corporation could endure. If the directors and officers of a corporation were allowed, in the conduct of the business and disposition of the property, to favor one or more shareholders to the detriment of the others, the minority would be the prey of the majority, for it would then be within the power of the majority to combine and elect

the officers, who in turn should manage the whole business and apply the whole corporate property for the benefit of the majority, and thus practically confiscate the entire property interest of the minority. Corporations would thus become traps for the unwary and legalized instruments of fraud. The doctrine that the directors are trustees for the shareholders, and for the equal benefit of all, it is obvious, is essential to the existence of corporations.

But it is the right of the creditors, equally with the shareholders, to have the corporate property applied to the purposes for which the corporation was created, and this includes the payment of the corporate indebtedness contracted in the prosecution of its business. The rights of the creditors to the corporate property, so far as it is necessary to meet their demands, are superior to those of stockholders.

In *Perry on Trusts*, section 242, the relative rights of the creditors and shareholders are thus defined: "A corporation holds its property in trust, *first*, to pay its creditors, and *second*, to distribute to its stockholders *pro rata*. If, therefore, a corporation should dissolve, and divide its property among its shareholders without first paying its debts, equity would enforce the claims of its creditors by converting all persons, except *bona fide* purchasers for value, to whom the property had come, into trustees, and would compel them to account for the property and contribute to the payment of the debts of the corporation to the extent of its property in their hands."

It is now firmly established that the property and assets of a corporation are a trust fund for the payment of its debts, especially in case of its insolvency. Since the case of *Wood v. Dummer*, 3 Mason 311, where Mr. Justice Story is said to have first formulated the doctrine, it has been generally accepted, and is sustained by the highest authority. Mr. Justice Swayne announces it with great clearness, in *Sanger v. Upton*, 91 U. S. 56, 60, as follows: "The capital stock of an incorporated company is a fund set apart for the payment of its debts. It is a substitute for the personal liabilities which subsists in private co-partnerships. When debts are incurred, a contract arises with the creditors that it shall not be withdrawn or applied, otherwise than upon their demands, until such demands are satisfied. The creditors have a lien upon it in equity. If diverted, they may follow it as far as it can be traced, and subject it to the payment of their claims, except as against holders who have taken it *bona fide* for a valuable consideration, and without notice. It is publicly pledged to those who deal with the corporation for their security." \* \* \*

[Citing and quoting from, to the same effect, *Curran v. State of Arkansas*, 15 How. 312; *Upton v. Tribilcock*, 91 U. S. 45, 47; *Haywood v. Lumber Co.*, 64 Wis. 639; *Taylor v. Miami Exporting Co.*, 5 Ohio 165; *Goodin v. The Canal Co.*, 18 Ohio St. 182.]

It being established that the corporate property is a trust fund for the benefit of the corporate creditors, it follows that after the insolvency of the corporation is ascertained, and the objects of its creation are no longer pursued, the managing board of directors then having the custody of the property, become trustees thereof for the creditors; and

this relation necessarily forbids any discrimination between the beneficiaries in the distribution or application of the fund. The due execution of the trust demands absolute impartiality toward the *cestui que trustent*. They must be treated alike, and no preference can be made among them without a direct violation of the duties arising from the relation. It would seem clear that, if the corporate property constitutes a fund for the creditors, it is as much so for one creditor as for another, and that the directors in possession are without authority to dispose of it in disregard of the rights of any creditor. They can no more discriminate between creditors in such cases than they could before the insolvency of the corporation between the shareholders. The objects for which the corporation was created being no longer prosecuted, and the occasion for the exercise by the board of directors of the power of control and disposition of the property for such purpose having ceased, there remains no purpose to which its assets can lawfully be devoted except to the payment of the debts.

In equity the corporate property becomes the property of the creditors, and their equities are equal. Every creditor, who became such by parting with his money, property or other thing of value to the corporation, contributed to the accomplishment of its purposes, and augmented its corporate fund; and when the fund is no longer demanded for the purposes of the corporation, the rights of the creditors become fixed instantly and equally; for each, having contributed to the common fund, has an interest in it, in proportion to his claim, equally with every other creditor. This interest is sometimes called the equitable lien of the creditor on the corporate property, which enables him to follow it, even after it has left the hands of the directors, wherever it can be found, except in the possession of *bona fide* purchasers for value, and subject it to the payment of the corporate indebtedness. It would seem to result, as a necessary consequence, that insolvent corporations which have ceased to carry on business can not, by pledge or mortgage of the corporate property to some of the creditors, in payment or security of antecedent debts, without other consideration, create valid preferences in their favor over others; and this is the view maintained by the more recent writers on the subject.

In the last edition of Taylor on Private Corporations, it is said: "When corporations become insolvent, the duty of the directors toward its creditors becomes even stricter and more imperative; for, under such circumstances, the rights of creditors are paramount, and it has become probable that they will be somewhat damaged; and the plain duty of directors who control the funds from which corporate debts are paid, is to see that the loss is as small as possible. Moreover, since, upon the insolvency of the corporation, the rights of unsecured creditors are equal, it would seem to be unlawful, even in the absence of a statute expressly forbidding it, for directors to make preferences among them." (Section 759.) And, in section 668, it is further said: "To allow an insolvent corporation to make an assignment of its property, giving preferences to a portion of its creditors over the others, is unjust, as well as utterly repugnant to the doc-

trine that corporate property is a trust fund, on the credit of which persons contract with the corporation. If such property constitutes such a fund, it is clearly held in trust for the benefit of one creditor just as much as another, and to prefer one creditor to another is evidently beyond the authority of the trustee. This view is far from being unsupported by direct authority."

Mr. Morawetz, in his excellent work on private corporations, referring to the cases which hold that corporate preferences are valid, says:

"This doctrine, in the opinion of the writer, is wholly indefensible on principle. The capital provided for the security of the creditors of a corporation is a fund held for the benefit of all the creditors equally. That the unsecured creditors of a corporation are entitled to an equal distribution of the common security, has often been recognized by the courts of equity in adjusting the rights of creditors among themselves and in relation to the company's shareholders. After a corporation has become insolvent, and has ceased to carry on business, the rights of its creditors become fixed. If a corporation, whose assets are not sufficient to satisfy all of its creditors in full, can prefer certain creditors, leaving others unpaid, this must be by virtue of a power reserved by implication to the company and its agents. But this power can not justly be included in the general powers of management which a corporation must necessarily possess over its property, in order to carry on its business and further the purposes for which the company was formed. The purposes of a corporation are not furthered in any manner by giving it or its agents the power, after the company has become insolvent and has ceased to carry on business, and after its shareholders have lost their interests in the corporate estate, to prefer a portion of the creditors, according to interest or mere whim, and to pay their claims in full, leaving the others wholly without redress. The doctrine that an insolvent corporation may prefer certain creditors at the expense of others, seems to have been first started in *Catlin v. Eagle Bank* (6 Conn. 233), a case in which the fundamental rule that the assets of an insolvent corporation constitute a trust fund pledged for the security of creditors was denied. It is a doctrine which is at variance with the whole theory of the law concerning the rights of creditors of insolvent corporations, and is contrary to the plainest principles of justice." (2 Morawetz Corporations, § 803.)

And in a very recent work on insolvent corporations it is said: "The practical working of the rule sustaining corporate preferences is monstrous. The unpreferred creditors have only a myth or shadow left to which resort can be had for payment of their claims; a soulless, fictitious, unsubstantial entity that can be neither seen nor found. The capital and assets of the corporation, the creditors' trust fund, may, under this rule, be carved out and apportioned among a chosen few, usually the family connections or immediate friends of the officers making the preference. This rule of law is entitled to take prec-

edence among the many reckless absurdities to be met with in cases affecting corporations, as being a manifest travesty upon natural justice." (Wait on Insolv. Corporations, § 162.) "Elsewhere we have deprecated the right, which is recognized in a number of cases, of insolvent corporations to make preferential assignments. It would seem to be an idle waste of words to designate the capital and assets of a corporation as a trust fund for the benefit and security of creditors in the event of dissolution or insolvency, if one of the first principles of the law of trusts—equality of distribution—could be openly violated, and the effects of the bankrupt company apportioned among a favored few." (Wait on Insolv. Corporations, § 654.)

Without extending the discussion, we are of opinion that when a corporation for profit, organized under the laws of this state, becomes insolvent and ceases to carry on its business or further pursue the purposes of its creation, the corporate property constitutes a trust fund for the equal benefit of the corporate creditors, in proportion to the amounts of their respective claims; and that it can not then, by pledge or mortgage of the property to some of its creditors as security for antecedent debts, without other consideration, create valid preferences in their behalf, over the other creditors, or over an assignment thereafter made for the benefit of creditors.

Instead of the individual liability of the stockholders being a ground of objection to this conclusion, it furnishes an additional reason in its support. It is well settled that the corporate property is the primary fund for the payment of the debts of the corporation, and the statutory liability of the stockholder is a security to be resorted to only when the payment of its debts can not be enforced against its property, and it was held in *Harpold v. Stobart*, 46 Ohio St. 397, decided at this term, that stockholders who have assigned their stock to an insolvent assignee, are liable only for such portion of the debts existing while they were such stockholders, as is equal to the proportion which their stock bears to the stock held by all stockholders liable for the same debts. Admit the power of the board of directors of an insolvent corporation to make preferences among its creditors, and it must follow that they may prefer any they choose to select for that purpose. This would be wholly inconsistent with the trust relation subsisting between the directors and shareholders, for since different stockholders, or classes of stockholders, may be liable for different debts, and not all for the same debts, if the directors could apply the corporate property to some of its debts, leaving others entirely unprovided for, they would be at liberty to select the debts for which particular stockholders alone were liable, and appropriate all of the property to their satisfaction, leaving the other stockholders to respond to the full extent of their statutory liability for the remaining debts. The directors would in this way be enabled to apply the whole corporate property to their own exoneration.

Whether an insolvent corporation, which is still a going concern, and in good faith engaged in the prosecution of its business, may borrow money, or contract, or procure an extension of other *bona fide*



indebtedness, and convey or pledge the corporate property in security thereof, is a question not involved in this case, and upon which we here express no opinion.

It appears from the finding of facts in this case that the directors of the corporation declared its insolvency, and directed by the same resolution the execution of an assignment for the benefit of its creditors, and of the preferential mortgages to the bank and other creditors. It does not appear that there had been any agreement between the mortgagees and the corporation that such mortgages should be given, nor that they were given for any other consideration than the antecedent indebtedness of the corporation to the creditors receiving them. Being merely voluntary mortgages to secure pre-existing debts, without other consideration, they can not prevail against the equitable rights of the corporate creditors. *Lewis v. Anderson*, 20 Ohio St. 281. \* \* \*

*Reversed.*

*Note. Accord:* 1893, *Lyons, Thomas H., Co. v. Perry*, 86 Tex. 143, 22 L. R. A. 802; 1895, *Tradesman Pub. Co. v. Knoxville, etc., Co.*, 95 Tenn. 634, 49 Am. St. Rep. 943, 32 S. W. Rep. 1097; 1895, *Pollak v. Muscogee, etc.*, 108 Ala. 467, 54 Am. St. Rep. 165; 1895, *Adams & W. Co. v. Deyette*, 8 S. D. 119, 59 Am. St. Rep. 751, 65 N. W. Rep. 471; 1897, *Cook v. Moody*, 18 Wash. 114, 63 Am. St. Rep. 872, note; 1897, *Campbell, etc., Co. v. Marder*, 50 Neb. 283, 61 Am. St. Rep. 573; 1897, *Memphis Barrel, etc., Co. v. Ward*, 99 Tenn. 172, 63 Am. St. Rep. 825; 1899, *Tate v. Commercial Building Assn.*, 97 Va. 74, 45 L. R. A. 243 (statute); 1899, *Burrell v. Bennett*, 20 Wash. 644; 1899, *Slack v. N. W. Nat'l Bk.*, 103 Wis. 57, 79 N. W. Rep. 51 (fraudulent preference); 1899, *U. S. Rubber Co. v. Am. O. L. Co.*, 96 Fed. Rep. 891 (same).

## Sec. 647. Same.

(c) Going concern,—attachment.

FLY, J., IN *AMERICAN NAT. BANK OF DALLAS v. DALLAS TIN-WARE MFG. CO. ET AL.*

1897. IN COURT OF CIVIL APPEALS OF TEXAS. 39 S. W. Rep. 955, on 957.

It would seem, from the language of the second issue submitted to the jury, which is similar to language found in the opinion in *Lyons-Thomas Hardware Co. v. Perry Stove Mfg. Co.*, 86 Tex. 143, 24 S. W. Rep. 16, that the trial court concluded that it had been held in that opinion that if the corporation “had taken, or was in the act of taking, any steps which would practically have incapacitated it from conducting its business with reasonable prospects of success,” the point had been reached when the property had become trust funds for all the creditors. No such inference can be legitimately drawn from that decision. It is true that very similar language is used in that decision, but it is copied from the case of *Corey v. Wadsworth* (Ala.), 11 So. Rep. 350. But the theory of that opinion was not adopted by the supreme court, and it was clearly indicated by language immediately following the quotation that the rule enunciated was not adopt-



ed. It was not necessary to the decision of the case before the supreme court, and was adopted only in so far as it held "that when a corporation's assets are insufficient for the payment of its debts, and it has ceased to do business," the point is reached where its property can not be attached at the instance of a creditor. The assertion in the opinion in *Rogers v. Lumber Co.* (Tex. Civ. App.), 33 S. W. Rep. 312, that the language of the opinion in *Corey v. Wadsworth* was approved by Judge Stayton, seems to be founded on a misconception of his language. The court of civil appeals on rehearing in the *Rogers Lumber Co.* case receded from the position it had taken in its original opinion, that a writ of attachment could not properly be levied on corporation assets after its insolvency, and placed its decision on the ground laid down in *Lyons-Thomas Hardware Co. v. Perry Stove Mfg. Co.*, that when a corporation has ceased to do business its property becomes a trust fund for the benefit of all the creditors. In the case of *Farmers' and Merchants' Nat. Bank v. Waco El. Ry., etc., Co.*, 36 S. W. Rep. 131, it was said by the court of civil appeals of the third district: "The supreme court has recently decided that no preference over general creditors can be acquired by levy upon the property of an insolvent corporation." But we have not seen any opinion of the supreme court in which such doctrine was enunciated, but in the cases of *Shoe Co. v. Thompson*<sup>1</sup> and *Moon Bros.' Carriage Co. v. Waxahachie Grain and Imp. Co.*,<sup>2</sup> hereinbefore cited, it was distinctly held that a preference over general creditors would be obtained by the levy of an attachment upon the property of an insolvent corporation, if it had not ceased to carry on its business in the usual course of trade.

See 1903, *Shields v. Hobart*, 172 Mo. 491, 95 Am. St. R. 529.

#### Sec. 648. Same.

(d) Extra-territorial effect of.

BROWN, Assoc. J., IN *FOWLER V. BELL ET AL.*

1896. IN THE SUPREME COURT OF TEXAS. 90 Texas Rep. 150, on 157 *et seq.*

The question involved is this, could the McLeod Artesian Well Company, a corporation doing business in this state, but created under the laws of the state of Iowa, being insolvent and having ceased to do business, make a mortgage upon its property in this state giving a preference to one or more creditors over others, which mortgage a corporation created under the laws of this state could not have made under similar conditions? In other words, do the general laws of another state govern in the interpretation of a contract made by a corporation of such state with reference to its property situated in this state, when such contract is in violation of the laws or public policy of this state?

<sup>1</sup> 35 S. W. Rep. 473.

<sup>2</sup> 35 S. W. Rep. 337.

Mr. Thompson, in his recent work on Corporations, volume 6, section 7885, states the rule, which we believe to be correct, as follows: "Without attempting to enumerate in a single section all the cases to which this comity does not extend, it may be observed, in the first place, that it does not extend so far as to concede to foreign corporations the powers which their own charters do not permit them to exercise, nor so far as to permit a foreign corporation to exercise powers within the state which a domestic corporation of the same kind is not permitted to exercise under the constitution and policy of the state."

This rule is well sustained by the authorities, of which we cite the following: *Falls v. U. S., etc., B. Co.*, 97 Ala. 417, 38 Am. St. Rep. 194; *Guilford v. Tel. Co.*, 59 Minn. 332, 50 Am. St. Rep. 407; *Hutchins v. The N. E. Coal and Mining Co.*, 4 Allen 580; *Milnor v. Railway*, 53 N. Y. 363; *Rorer on Interstate Law*, 288.

Morawetz on Private Corporations, section 976, volume 2, states the proposition thus: "It is the charter alone which is recognized by the law of comity, and not the general legislation of the state in which the corporation was formed. The word charter is here used to signify the agreement between the shareholders of the corporation, whether this agreement be contained in a special act of the legislature or in articles of association or in either of these taken in connection with certain general laws of the state."

"The law of comity merely enables the corporators to exercise the franchise of acting in a corporate capacity in foreign states, and the extent of this franchise is determined by the agreement entered into when the charter was accepted. The laws of the state where the corporation was formed by the agreement of the corporators are regarded only so far as they determine the scope and validity of this agreement itself."

"The general law and regulations of a state are intended to govern only within the limits of the state enacting them, and the state would have no power to give them extra-territorial force. \* \* \* It follows, therefore, that if a statute enacted by a state, whether as a general law or as a special provision in the charter of a corporation, was enacted for the enforcement of a local policy only, it would not be presumed that such statutory provision was intended by the state or by the shareholders forming the corporation to enter into the charter contract and to regulate the company in its transactions outside of the state, and such enactment will, therefore, not affect the validity of the dealing of the company in foreign states."

Applying these principles of law to the facts of this case, it follows that, if the mortgage in question was made contrary to the laws of this state or to its public policy, it is void, and conferred no rights upon the mortgagee. A corporation created in this state, which has become insolvent and has ceased to carry on its business, can not make any disposition of its property which gives a preference to one or more creditors over others, for the reason that, upon insolvency and cessation of the business, the assets of the corporation by operation of the law becomes a trust fund in the hands of its directors to be

disposed of for the benefit of its creditors, and any disposition which discriminates between such creditors is a violation of that trust. *Lang v. Dougherty*, 74 Texas 226; *Hardware Co. v. Mfg. Co.*, 86 Texas 143.

If the McLeod Artesian Well Company had been a domestic corporation and had made the mortgage in question under the same conditions it would be void because contrary to the laws and public policy of this state, as declared in the decision of its court as above cited: and it must be so held in this case unless its validity can be supported upon the ground that it is sustained by the laws of the state of Iowa.

Counsel for the defendants in error claim that the mortgage in question in this case is valid for the following reasons:

1. That there is no law in Texas which renders such transaction invalid, but that the decisions of our courts, and especially that of *Lyons-Thomas Hardware Co. v. Manufacturing Co.*, rest upon the ground that the statutes of this state do not confer upon corporations power to make such instruments.

2. Because the transaction is to be governed by the laws of Iowa, where the contract was made, and in which state it would be valid, and not by the laws of Texas.

In the case of *Lyons-Thomas Hardware Co. v. Manufacturing Co.*,<sup>1</sup> cited above, Judge Stayton reviewed the authorities exhaustively to show that an insolvent corporation which had ceased to do business could not make a mortgage giving preferences to some creditors over others, for the reason which we have before stated, that upon the happening of such conditions the directors of the corporation by operation of law become trustees charged with the distribution of its assets among all of its creditors, and thus being constituted trustees they could not deprive the beneficiaries of that trust of their proportionate part of the assets of the corporation by means of conveyances of the property so held to one or more of the creditors in preference to the others. The decision is not placed upon the ground that the authority is not conferred upon the corporation by the laws of this state, as is insisted by counsel for the defendant in error, but in that case it was insisted that a corporation had the inherent right at common law to make such a conveyance. Judge Stayton conclusively showed, from the best considered authorities, that the rule claimed applied only to common-law corporations, and not to those created by statute, and then, in order to conclusively show that the rule announced as applicable to insolvent corporations applied in this state under such circumstances, he examined our statutes, from which examination it appeared that no such authority had been either directly or by implication conferred upon corporations in this state. That case clearly settled the law upon this question in Texas, and it is no longer open to controversy that an insolvent corporation can not, in this state, when it has ceased to perform the business for which it was created, dispose of its assets so as to deprive its creditors of a fair and just distribution of the same.

In support of the second proposition above stated, it is claimed that

<sup>1</sup> 86 Tex. 143.

this mortgage having been executed in Iowa, where the law permitted such disposition of the property, it is to be governed in its construction and enforcement by the laws of that state. We will remark, however, that it was made with a view to its enforcement in Texas, and embraced alone property situated in Texas. \* \* \*

(After reviewing *Ryan v. Railway*, 65 Tex. 13; *Weider v. Maddox*, 66 Tex. 372; *Rue v. Railway*, 74 Tex. 479; *Estate of Prime*, 136 N. Y. 347; *Barth v. Backus*, 140 N. Y. 230, proceeds:)

We are earnestly asked to carefully examine *Vanderpoel v. Gorman*, 140 N. Y. 563, which, upon careful examination, we find to be a case in which a corporation created under the laws of New Jersey, doing business in the state of New York, made a general assignment for the benefit of all of its creditors without preferences. An attachment was levied in the state of New York upon the property assigned, and the assignee brought suit to recover damages for the levy upon and sale of the property. The defendant in that suit claimed that the assignment was void on account of the provisions of a statute of the state which, among other things, provided: "That no corporation shall make any transfer or assignment to any person whatever in contemplation of its insolvency, and every such assignment is declared to be void."

It was claimed that the foreign corporation was embraced in the general language of this statute. The court held that the law above quoted did not apply to foreign corporations. That court also held that the right to make such an assignment as was made in that case was inherent in all corporations unless prohibited, and not being prohibited to the foreign corporation by the terms of the statute, the assignment was not violative of any law in the state of New York. There are two marked distinctions between that case and this:

1. The instrument in that case was of a character which the laws of New York permitted to be made and which the courts of that state held all corporations had the inherent power to make unless restrained therefrom. In this case the instrument is one which the courts of this state held that no corporation has the power to make unless authorized by statute of this state.

2. In that case the instrument was a general assignment distributing all of the assets of the corporation equally among the creditors, which is not denounced by any decision in this state. While the instrument in this suit is one which is not approved by the New York case, but is directly and emphatically denounced by the laws of this state as embodied in the decisions of its courts.

The two cases are so dissimilar that the one is not authority in the consideration of the other. \* \* \*

If the power claimed for the Artesian Well Company had been explicitly expressed in its charter, it could not have been exercised in this state by that corporation, because in direct conflict with the laws and policy of this state, and in such conflict the law of this state must prevail over the foreign law. *Falls v. U. S. Bldg. Co.*, 97 Ala. 417.

We hold that the mortgage executed by the McLeod Artesian Well

Company to Mrs. Bell was null and void, and that the district court erred in foreclosing it upon the property embraced therein and in giving judgment against the defendant Fowler for the said property, or the value of any part thereof, and that the court of civil appeals erred in affirming the said judgment. \* \* \*

**Sec. 649.** 7. To prefer officers. Theories:  
(a) Can not.

OLNEY ET AL. V. THE CONANICUT LAND CO. ET. AL.

1889. IN THE SUPREME COURT OF RHODE ISLAND. 16 R. I. Rep.  
597-603, 27 Am. St. Rep. 767.

Bill in equity to annul a mortgage and for a receiver.

STINESS, J. The complainants, judgment creditors of the Conanicut Land Company, seek to set aside a mortgage given to the defendants, Lippitt, Davis and Bradford, to secure them for advances, and for their indorsements of the notes of the company. The mortgage was given immediately after the complainants had brought suits for damages against the company for negligence, and when the company was insolvent, the agreed statement of facts showing that it had not sufficient assets with which to discharge all its outstanding indebtedness, were payment of the same to be demanded when due. Since then the complainants have levied execution on the property of the company. The complainants claim that, as the mortgagees are three of the four directors who voted to give the mortgage, thereby securing themselves, their action is so inconsistent with their fiduciary relation that it should be set aside. No fraudulent act in regard to the giving of the mortgage is alleged other than the fact itself, and the case being submitted on bill, answer and agreed facts as to the validity of the mortgage, we have the simple question whether directors of an insolvent corporation are debarred in equity, by virtue of their position, from preferring debts due to themselves. In so far as the mortgage is to be regarded as a mere preference, it is not contended that it is invalid. Except as limited by statute, the right of a debtor to prefer a part of his creditors has always been upheld in this state. *Dockray v. Dockray*, 2 R. I. 547; *Elliot v. Benedict*, 13 R. I. 463.

The vital question is, whether a director of an insolvent corporation is to be regarded as a trustee for its creditors. If he is so, the duty of a trustee to a *cestui trust* is plain. For a trustee to collect his own debt, to the detriment of that of his *cestui*, is a clear breach of fidelity. When one accepts the trust of caring for another's interest he accepts the attendant duty. It must be admitted that directors of a corporation are not technical trustees. They do not have in themselves the title to property which they hold for the benefit of others; and certainly, as to creditors, they are under no express trust. The

corporation is a legal being, distinct from its stockholders and officers. It may deal with them as individuals and may owe them debts. It holds its own property, and has the capacity and responsibility of acting for itself. Nevertheless the conduct of its affairs must, of necessity, be intrusted to officers in whom confidence is reposed, to whom large powers are given, and by whom its property is managed for the common benefit. As corporations have multiplied and have become so greatly concerned in business affairs in recent years, the obligations arising from such a relation have become correspondingly prominent. While the decisions in regard to this relation are not harmonious, it has been generally agreed that directors are trustees for stockholders. This being established, we think it follows naturally that, when the corporation becomes insolvent and the stockholders have no longer a substantial interest in the property of the corporation, directors should be regarded as trustees of the creditors to whom the property of the corporation must go. If directors, with their office, assume the duty of caring for the interests of the stockholders, why do they not also assume the duty incidentally of caring for the interests of those who, instead of the stockholders, may come to have claims upon the corporate property?

In speaking of directors as trustees for stockholders, Mr. Justice Miller, in *Sawyer v. Hoag*, 17 Wall. 610, calls this "a doctrine of modern date," but as long ago as the time of Lord Hardwicke we find the duties and obligations of a director of a corporation thus clearly set forth: "I take the employment of a director to be of a mixed nature; it partakes of the nature of a public office, as it arises from the charter of the crown. But it can not be said to be an employment affecting the public government. Therefore, committeemen are most properly agents to those who employ them in this trust, and who empower them to direct and superintend the affairs of the corporation. By accepting a trust of this sort, a person is obliged to execute it with fidelity and reasonable diligence, and it is no excuse to say that they had no benefit from it, but that it was merely honorary, and, therefore, they are within the case of common trustees." *Charitable Corporation v. Sutton*, 2 Atk. 400. To the effect that the officers of a corporation are trustees for the stockholders, see *Hodges v. New England Screw Co.*, 1 R. I. 312; *Hoyle v. Plattsburgh and Montreal R. R. Co.*, 54 N. Y. 314; *Koehler v. Black River Co.*, 2 Black 715; *York and North Midland Railway Co. v. Hudson*, 16 Beav. 485, 19 Eng. Law & Eq. 361; *Great Luxembourg Railway v. Magnay*, 25 Beav. 586; *Hope et ux. v. Valley City Salt Co.*, 25 W. Va. 789. Indeed, no cases that we know of deny a fiduciary relation of directors to stockholders, however they may differ in the use of terms to describe it. This relation has led logically to the conclusion that in case of insolvency, the assets of the corporation being no longer held for the benefit of stockholders, but for the benefit of creditors, the directors owe to the creditors the duty of a trustee. This duty is clearly stated by Clifford, J., in *Bradley v. Converse*, 4 Cliff. 375: "Assets of an incorporate company are regarded in equity



as held in trust for the payment of the debts of the corporation, and courts of equity will enforce the execution of such trusts in favor of creditors, even when the matter in controversy may not be cognizable in a court of law. Such assets are usually controlled and managed by directors or trustees, but courts of equity will not permit such managers in dealing with the trust estate, in the exercise of the powers of their trust, to obtain any undue advantage for themselves, to the injury or prejudice of those for whom they are acting in a fiduciary relation. Exact equality of benefit may be enjoyed, but the trustees are forbidden to protect, indemnify or pay themselves at the expense of those who are similarly in relation to the same fund."

To the same effect are *Bradley v. Farwell*, 1 Holmes 433; *Jackson v. Ludeling*, 21 Wall. 616; *Corbett v. Woodward*, 5 Sawyer 403; *Stout v. Yaegers Milling Co.*, 13 Fed. Rep. 802; *Haywood v. Lincoln Lumber Co.*, 64 Wis. 639; *Richards v. New Hampshire Ins. Co.*, 43 N. H. 263; *San Francisco and North. Pacific R. R. Co. v. Bee*, 48 Cal. 398; *Gaslight Improvement Co. v. Terrell*, L. R. 10 Eq. 167; *Hopkins & Johnson's Appeal*, 90 Pa. St. 69. Of the cases cited by the defendants, only three fully sustain their claim that, as creditors of the company, directors may, in the absence of fraud, secure themselves for their own debt, viz.: *Burr's Executors v. McDonald*, 3 Grat. 215; *Planters' Bank of Farmville v. Whittle*, 78 Va. 737; *Garrett v. The Burlington Plow Co.*, 70 Iowa 697. \* \* \*

We think the weight of recent authority regards directors of an insolvent corporation as trustees for creditors, and that this authority stands upon the better reason. If, as Judge Dillon said, the right to collect a debt is "a race of diligence," open alike to both, it must be admitted that it is a race in which the outside creditor is unduly handicapped. The parties do not contend upon an equal footing, and, although it is said that the director has only an advantage which results from his position, and which is known to all who deal with the corporation, yet no one would say that an ordinary trustee should be entitled to an unequal start with his *cestui*, by means of information received in the discharge of his trust. If, then, the director be a trustee, or one who holds a fiduciary relation to the creditors, in case of insolvency he can not take advantage of his position for his own benefit to their loss. The right of the creditor does not depend upon fraud or no fraud, but upon the fiduciary relation. \* \* \*

*Note. Accord:* Note, 45 Am. St. Rep. 835; note, 57 Am. St. Rep. 78; 1889, *Beach v. Miller*, 130 Ill. 162, 17 Am. St. Rep. 291, note; 1891, *Oorey v. Wadsworth*, 99 Ala. 68, 42 Am. St. Rep. 29; 1893, *Hill v. Lumber Co.*, 113 N. C. 173, 37 Am. St. Rep. 621; 1895, *Adams & Westlake Co. v. Deyette*, 8 So. Dak. 119, 59 Am. St. Rep. 751; 1897, *Campbell, etc., Mfg. Co. v. Marder*, 50 Neb. 283, 61 Am. St. Rep. 573; 1899, *Slack v. Northwestern Natl. Bank*, 103 Wis. 57, 74 Am. St. Rep. 841; 1900, *James Clark Co. v. Colton*, 91 Md. 195, 49 L. R. A. 698; 1902, *Williams v. Turner*, — Neb. —, 88 N. W. 668; 1903, *Shields v. Hobart*, 172 Mo. 491, 95 Am. St. R. 529, 72 S. W. 669.

Compare, 1902, *Graham v. Carr*, — N. C. —, 41 S. E. 379.

**Sec. 650. Same. Reasons.**

WOOD, J., IN HOWE, BROWN & CO. v. SANDFORD FORK AND  
TOOL CO. ET AL.

1890. IN THE UNITED STATES COURT, DISTRICT OF INDIANA. 44  
Fed. Rep. 231, on 233.

It seems to me enough to say that a sound public policy and a sense of common fairness forbid that the directors or managing agents of a business corporation, when disaster has befallen or threatens the enterprise, shall be permitted to convert their powers of management and their intimate, and it may be exclusive, knowledge of the corporate affairs into means of self-protection to the harm of other creditors. They ought not be competitors in a contest of which they must be the judges. The necessity for this limitation upon the right to give preferences among creditors when asserted by corporations may not have been perceived in earlier times, but the growing importance and variety of modern corporate enterprises and interests, I think, will compel its recognition and adoption. The fact in this case that the stockholders authorized the making of the mortgage seems to be immaterial. That action was, it is averred, procured by the directors proposed to be benefited, they themselves being stockholders; and, even if this were not averred, the case would not, I think, be essentially different. Whether or not such preferences are fairly given is an impracticable inquiry, because there can be in ordinary cases no means of discovering the truth, and, consequently, the presumption to the contrary should in every case be conclusive. Concede that it is a question of proof, and that a preference in favor of a director will be deemed valid if fairly given, and it may as well be declared to be a part of the law of corporations that in cases of insolvency debts to directors and liabilities in which they have a special interest must be first discharged. That will be the practical effect, and the examples will multiply of individual enterprises prosecuted under the guise of corporate organization, for the purpose, not only of escaping the ordinary risks of business done in the owner's name, which may be legitimate enough, but of enabling the promoters and managers, when failure comes, to appropriate the remains of the wreck by declaring themselves favored creditors. Besides inconsistency with that equality which equity loves, such favors involve too many possibilities of dishonesty and successful fraud to be tolerated in an enlightened system of jurisprudence.

Sec. 651. Same. (b) Can.

McCLELLAN, C. J., IN COREY V. WADSWORTH ET AL.<sup>1</sup>

1897. IN THE SUPREME COURT OF ALABAMA. 118 Ala. Rep. 488, on 493-497, 499, 502, 503, 44 L. R. A. 766.

One of the main questions in this case is whether an insolvent and failing corporation can make a valid transfer of property to one of its directors in payment of a debt owing from the corporation to him, thus preferring him to other creditors in the payment of its debts, or, perhaps more accurately, whether directors of such corporation can prefer themselves in the payment of corporate debts. The writer not only has very affirmative views favorable to the validity of such a transfer on abstract principles, but he is further quite convinced that the point has been to all intents and purposes so decided by this court. We are, of course, aware that many courts have held the contrary view, and some of the text-writers have strongly condemned the doctrine we believe to be absolutely sound; some of them, indeed, resorting largely to invective and epithet in denunciation of the idea that a corporation may pay a just debt to an honest creditor, though he be a director, in preference to the just debts of other honest creditors who are strangers to the corporation. We have no epithets to apply to such courts and writers, nor to the rule they declare. Many of them are able expounders of the law, and all of them are doubtless actuated only by a purpose to ascertain and expound the true principle in this connection. And they may be right, and we wrong; but we do not think so, and we shall endeavor to give the reasons for the faith that is in us.

We are utterly unable to conceive upon any just and sound principle or consideration the least shadow of difference or distinction between the debt of a director and the debt of a stranger against a corporation upon which could be predicated one rule in respect of a preference by the corporation in the payment of the former and another rule in respect of such preference in payment of the latter. Take the case we have here, assuming for the discussion of the point immediately under consideration that the transaction involves no actual fraud. The corporation is a going concern, and its managers do not contemplate its failure. But it is in debt and needs money to continue its business and to pay its maturing obligations. It borrows the money from a director directly or through a pledge of his credit. At the same time it incurs debts to strangers for supplies necessary in its business. The money borrowed from the director is used for corporate purposes. It is paid out to other creditors, or is applied to liquidate corporate expenses. So, also, the supplies constituting the consideration of the debts to strangers are applied to the authorized

<sup>1</sup> This case covers fifty-nine pages, and is entirely too long to print here. Only the most forcible arguments of McClellan, C. J., can be here given. He covers the whole ground, both upon reason and authority, in an exhaustive way. Coleman, J., dissents in a very vigorous and exhaustive opinion.

uses of the corporation and inure to its advantage. There is nothing covinous in the creation of either class of debts. \* \* \*

A step further in unfolding this question and case: The expectations of the officers and managers of the corporation, entertained at the time of borrowing the money on the faith of the director, as to keeping the corporation a going concern and continuing indefinitely to carry on its business are disappointed. They find that notwithstanding the personal efforts of the director in pledging his credit to raise money for the business and creditors of the concern, the corporation can not keep its head above water, but must discontinue its business, cease to be a going concern and apply its assets to the payment of its liabilities. Among these liabilities they find the debt due its director for money borrowed, and a debt due a stranger for property purchased. The assets are sufficient to pay one in full and a percentage only on the other. The debts were equally just and *bona fide* in their inception. The corporation and its creditors have been equally benefited by each of the transactions by which these debts, respectively, were incurred. Neither is tainted by any infirmative circumstance whatever. There is no more abstract justice in paying the stranger in full to the exclusion of the director, than in paying the director in full to the exclusion of the stranger. If one may be so paid, so may the other upon every conceivable consideration of justice and right. That the stranger creditor may be so paid to the exclusion of the director creditor nobody denies. Indeed there is a sort of alacrity and joyousness in many of the authorities so holding, as if the director creditor had been guilty of some enormous wrong or crime in advancing his money to the corporation for the primary benefit of its stranger creditors without reward or the hope thereof, and he and his claim for simple reimbursement were unclean and unrighteous things before the law. That the director creditor may be so paid is strenuously denied by many authorities, sometimes with an acerbity of statement and a bitterness of denunciation which happily is rarely found in judicial writings. And why may the director creditor not be so preferred and paid? Confessedly his debt is a just one. Confessedly the corporation, its business and its creditors are benefited by the consideration of it as fully as by the consideration of the debt due the stranger creditor. Confessedly under a general assignment by the corporation he would be entitled to share upon the same footing as the stranger creditor. Confessedly, indeed, in every contingency and under all circumstances and conditions the director creditor and his claim stand upon the same footing and have the same rights as the stranger creditor and his claim, except only that, as is insisted, the corporation may prefer and pay the latter in full while the preference and payment in full of the former is fraudulent and void. There is, we are firmly of the opinion, no reason whatever for this distinction; and we believe it can be so demonstrated.

Let us first examine the reasons which are advanced by the judges and writers who hold to that view. Nearly all of the adjudged cases which hold that an insolvent and failing corporation can not convey

property to its officers and directors in payment of their debts in preference to the debts of stranger creditors rest their conclusions entirely upon the ground that the assets of such corporation constitute a trust fund in the hands of its officers and managers as trustees for the payment of its debts, and that such trustees can not pay themselves in preference to other creditors. We content ourselves upon this point by saying that this "trust fund doctrine" has been utterly repudiated in this state in a thoroughly considered case, and by an opinion prepared with considerable care and research in which all the judges of this court concurred. *O'Bear Jewelry Co. v. Volfer & Co.*, 106 Ala. 205; s. c., 28 L. R. A. 707; s. c., 54 Am. St. Rep. 31. But leaving the trust fund doctrine out of the case, it is sought to rest the conclusion that the transfer to a director involved in this case is fraudulent upon other grounds, being the same to which a text-writer or two, and, perhaps, some courts, have referred a like conclusion. And what are they?

In the first place the notion is advanced that such a transfer involves the reservation of a benefit to somebody—whether to the corporation or to the director creditor or to the other creditors is not made at all clear in the statement of the general proposition; and when a more concrete statement is ventured upon, the identity of the person or entity receiving an undue benefit becomes more and more uncertain. And we do not hesitate to maintain that no benefit is, in such transaction, reserved, or in any way inures to anybody beyond what the law clearly and fully contemplates, allows and approves. What is a benefit reserved which will vitiate the transfer of property by an insolvent and failing debtor in the payment of a debt? Is it not in the nature of things an *undue* benefit? Is it not essentially and necessarily the securing of some advantage beyond and in addition to the satisfaction of the debt sought to be paid? Can there be any such thing as the reservation of a benefit when the whole effect of the transaction is the payment of a just and honest debt by the transfer to the creditor of property precisely equal in value to the amount of the debt? \* \* \*

The whole end of the law is, that all the property of an insolvent debtor shall be applied to his debts. The debtor may be a father, son, brother, husband, wife, principal, agent, corporation or individual. Whatever the outside relations are, the law requires only that his assets shall go to his creditors, and does not require that they shall go to them ratably; but only that for each dollar in value of such assets a dollar of honest indebtedness shall be paid, wholly irrespective of whether the debt so paid is due to one creditor or many, or to all of the many. We draw a line. Upon one side of it is the insolvent debtor and his insufficient property. On the other are ranged his creditors and their claims. The law is simply and merely that that property must pass to the other side of that line, to somebody on the other side, and to the payment, in whole or part, as the case may be, of some to the exclusion of other claims on that side, or of all of them ratably. The property must go to the indebtedness; it must reduce the aggregate of the claims of the several creditors considered as one

gross sum, and though it thus reduce the gross indebtedness only by satisfying in full a particular item entering into the aggregate, by paying one claim in full and nothing on the others, the law is satisfied, its ends have been met, its purpose effectuated; no undue benefit has been reserved; no undue advantage has been taken; and it lies in no man's mouth to complain.

But it is said that "the officers of an insolvent corporation are in a position to know the real condition of the corporation, an advantage not attainable by creditors generally," and for this reason preferences in the payment of their debts should not be allowed. Has it ever been suggested before that better knowledge of a debtor's pecuniary condition by a particular creditor was any ground for declaring fraudulent and setting aside a preferential transfer to such creditor? Was such a doctrine ever ruled by any court? \* \* \*

The suggestion that a transfer by directors to one of their number of property in payment of a debt is invalid as being the act of the party accepting the transfer has no merit dissociated from the exploded "trust fund" doctrine. On that doctrine the directors become trustees, and on the principle that a trustee can not transfer the trust estate to himself as an individual, is rested the further proposition that directors of an insolvent corporation can not, being trustees, transfer its property to themselves in payment of debts which the corporation owes them. But with the elimination of the main proposition, that such directors are trustees, falls the dependent proposition that they can not prefer themselves in the payment of debts. With the trust fund doctrine out of the way, the separate corporate entity continues to exist for all purposes, wholly unaffected by the fact of insolvency, and its functions must continue to be performed. These functions are performed by the directors, for and in the name of the corporation, and their official acts are not their individual acts at all, but the acts of the corporation; and not being trustees for creditors, their acts when assailed by creditors are not subject to the rule that if a trustee contracts with himself in reference to the trust estate his acts are void at the election of or as against the *cestui que trust*. There being, in such case, no trustee, and no relation of trustee and *cestui que trust* between the directors of the corporation and its creditors, the matter stands thus: A corporation without assets to pay all its debts, owes its directors and it owes strangers. The debts of the two classes of creditors are equally honest and just, and stand upon the same footing in law and in equity. The corporation has an undoubted right to pay some creditors to the exclusion of others. Any creditor has the undoubted right to accept a preference. The corporation has the same right to pay its directors as it has to pay strangers. The directors have the same right to preferential payment as do strangers. To the exercise of this undoubted right to make preferences it is essential that the corporation must act. It can only act through the directors. If the directors can not act to the end of preferring their own just debts—having the undoubted right to such preference—the preference can not be made, and the undoubted right of the corpora-



tion to make it and of the directors to accept it is denied and defeated. The ends of the law that the assets of the corporation shall be applied to such of its debts as the corporation prefers is defeated. And for what? Upon what ground? Not that the directors are under any incapacity to prefer themselves which can be referred to any principle of law. Not that they are trustees, for they are not trustees for the creditors. Not that they are agents of other creditors, for they are not such agents. Not that they occupy any other fiduciary relation to other creditors, for being only the agents of the corporation, and, in that capacity only, the trustees for stockholders alone, they bear and can bear to the creditors, who have to do with the corporation as an entity and not with the shareholders at all, only the relation of the agent of a debtor to his creditor, a relation which is obviously as devoid of every attribute of a fiduciary character as the direct relation of debtor and creditor. Upon what ground, then, we repeat, is rested the idea that directors can not prefer themselves? Getting away from the trust-fund doctrine, it is based upon the bald assertion that the director in such case is acting both for the corporation and himself, in contracting in his representative capacity with himself as an individual; and this, it is said, the law will not allow. That is the sole ground put forward. It can not for a moment be sustained upon principle or well-considered authority. The results claimed do not follow.

The contract of a director with himself as an individual, the sale of corporate property by directors to themselves as individuals, is not void even as against the corporation itself or the stockholders. Upon all reason and authority it is perfectly valid, if not disaffirmed by the corporation itself or the stockholders. And the election belongs exclusively to the corporation and stockholders. If they do not exercise it, the transaction must stand. Strangers, of course, can not question it, for they are wholly without interest in the premises. General creditors can not question it, since no right of theirs has been violated by it. They can not hold the directors to account as fiduciaries, as there are no fiduciary relations between them. As creditors their only right is to have the corporate assets applied to just corporate debts, and this right is not impinged upon, but, to the contrary, fully conserved by the payment of the just debts of the directors. They have no lien upon corporate assets; they have no rights of ownership in corporate property. They can not claim their debts should be paid in full to the total or partial exclusion of other equally honest and just debts. The property not being impressed with a trust in their favor, and standing as they do in no superior right to director creditors, they, the right of preference being recognized, have no shadow of right to insist upon even a *pro rata* application of the assets to all indebtedness, their only right is to insist that all the assets shall be applied preferentially or otherwise to the indebtedness; and this right is absolutely subserved, as we have seen, by the payment of director creditors to the exclusion of stranger creditors. They have no right to insist upon the equal payment of all debts *pro rata*. The right of preference,

which every debtor confessedly has, necessarily involves favoritism, the right of choice of one creditor, and of any one creditor, to the exclusion of others. It is utterly inconsistent with all notions of equality, and as a natural person may prefer his relatives and friends to the exclusion of strangers, so an artificial person may prefer its friends and those occupying official relations to it to the exclusion of strangers. There is, the writer thinks, no semblance of sound principle or well-considered authority for a different conclusion. \* \* \*

*Note. Accord:* 1890, Rollins v. Shaver Co., 80 Iowa 380 (attachment); 1892, Gould v. L. R. M. R. & I. R. Co., 52 Fed. Rep. 680; 1895, Sanford Fork & T. Co. v. Howe B., etc., Co., 157 U. S. 312 (mortgage to secure a loan to the corporation by directors); 1895, Schufeldt v. Smith, 131 Mo. 280, 52 Am. St. Rep. 628; 1895, Bank v. Dovetail, etc., Co., 143 Ind. 550, 52 Am. St. Rep. 435; 1897, South Bend Chilled Plow Co. v. Cribb, etc., Co., 97 Wis. 230; 1897, Atlas Tack Co. v. Hardware Co., 101 Ga. 391 (claim secured by directors); 1897, Butler v. Harrison L. & M. Co., 139 Mo. 467, 61 Am. St. Rep. 464; 1898, Rockford Wholesale G. Co. v. Standard G. & M. Co., 175 Ill. 89, 67 Am. St. Rep. 205 (claim secured by directors); 1898, National Bank v. Scott & Co., 18 Utah 400, 55 Pac. Rep. 374; 1899, Millsaps v. Chapman, 76 Miss. 942, 71 Am. St. Rep. 547 (mortgage to secure a loan by directors); 1898, Anderson v. Bullock Co. Bk., 122 Ala. 275, 25 So. Rep. 523; 1900, Converse v. Sharpe, 161 N. Y. 571 (secured loan made by director in good faith, when the corporation was thought to be solvent); 1901, American Exchange Natl. Bk. v. Ward, 111 Fed. 782, 49 C. C. A. 611, 55 L. R. A. 356; 1902, Hogsett v. Columbia Iron & Steel Co., 203 Pa. St. 148, 52 Atl. 179; 1902, Swentzel v. Franklin Inv. Co., 168 Mo. 272, 67 S. W. 596; 1902, Nappanee Canning Co. v. Reid, etc., Co., 159 Ind. 614, 59 L. R. A. 197, 64 N. E. 870, 1115.

## ARTICLE II. RIGHTS OF CREDITORS.

**Sec. 652. 1. In general:** "The legal relations between a creditor and the corporation are occasioned either by a contract binding on the latter, or by a tort, for which it is responsible. Before the claims of a creditor arise, and during the transaction itself on which his claims are based, the creditor is simply an outsider towards whom the corporation, or the corporate agent with whom the creditor contracts, owes no duty not due to members of the public at large. And creditors will rarely have any standing in court to object to acts of the corporation done before their claims arose. From the moment, however, that a person becomes a creditor, the corporation owes it to him to satisfy his claim from the corporate funds, and is under a duty towards him which he may enforce, not to waste the corporate funds or divert them from the purposes for which they were set apart. From that moment the corporation, having in charge funds in regard to which the creditor has rights, occupies, because it has such funds in charge, a position of trust towards him." Taylor Private Corporations, § 651. See, *supra*, §§ 197, 204, and ch. 12, pp. 914-936, *supra*.

"As a general rule the rights and remedies of the creditors

of a corporation against it are the same, both at law and in equity, as the rights and remedies of the creditors of a natural person are against him. They may sue the corporation at common law, and recover a judgment against it, and may enforce the judgment by execution against the corporate assets. Like creditors of a natural person, also, they may come into a court of equity and reach and subject equitable assets of the corporation to the satisfaction of their claims. Creditors of a corporation may also attach the property of a corporation under the statutes, where the property of a natural person could be attached. A corporation is a 'person' within the meaning of the attachment laws." Clark, Corporations, § 214.

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Sec. 653. 2. At law; execution, etc.

THE LOUISVILLE, NEW ALBANY AND CHICAGO RAILWAY COMPANY v. BONEY.<sup>1</sup>

1888. IN THE SUPREME COURT OF INDIANA. 117 Ind. Rep. 501-511.

[In 1874, Boney, under a contract, constructed some three miles of the road-bed of the I. D. & C. R.; in 1875 he gave notice of a contractor's lien, specifying the amount due for work. In 1876 he began suit against the company, got a personal judgment and decree foreclosing his lien, under which part of the road-bed of the company was sold, and which Boney purchased for part of the amount of his judgment; afterwards he levied upon other parts of the road-bed. Afterward, without making Boney a party, under foreclosure proceedings under a mortgage subsequent to Boney's lien, all the property and franchises of the company were sold to a new corporation called the C. & I. A. L. R. Co., which, in 1881, completed and put in operation the railroad, including the three miles purchased by Boney, and the rest of the road-bed upon which he had levied execution. Afterward the C. & I. A. L. Co. was consolidated with the Louisville, New Albany & Chicago Ry. Co., which has continuously operated and claimed to own all the former road. In a suit, in which Boney and this company were both parties, it was adjudged that Boney had acquired nothing by his former purchase of, or levy upon, the property. He thereupon instituted this suit in the nature of a creditor's bill to establish his claim against the company, and obtain a decree for the sale of the road; in this suit he obtained judgment for \$4,580, and for default of payment for forty days an order to sell the railroad, with all its rights, franchises, privileges and immunities. From this the company appeals.]

MITCHELL, J. \* \* \* (After holding there was no error in render-

<sup>1</sup> Statement abridged; part of opinion omitted.

ing a judgment *in personam* against the appellant as successor of the former company, proceeds:)

The other feature of the case presents a question of much greater difficulty. According to the established rule of common law, which controls the current of modern authority, the franchises of a corporation, mere incorporeal hereditaments, were not subject to seizure and sale upon execution, in the absence of express statutory provisions authorizing the sale and prescribing the method of transfer. It follows, as a natural sequence, that lands, easements, or things essential to the existence of the corporation and the execution of its corporate duty, and without which its franchise would be of no practical use, can not be levied upon and sold on execution at law, so as to detach them from the franchise and thus destroy its use. *Indianapolis, etc., G. R. Co. v. State, ex rel.*, 105 Ind. 37; *Ammant v. President, etc.*, 13 S. & R. 210; *Baxter v. Turnpike Co.*, 10 Lea 488 (4 Am. & Eng. Corp. Cases 134); *Herman Ex.*, § 361.

Thus it has been said, in effect, that the franchises and corporate rights of a company, and the means which are necessary to enable it to maintain its existence, and subserve the objects and purposes of its creation, are incapable of being granted away or transferred by any act of the company, without express authority, or by any adverse process against it. *Susquehanna Canal Co. v. Bonham*, 9 W. & S. 27.

Accordingly, where, upon an execution issued on a judgment recovered against a canal company, the marshal had seized and advertised for sale a toll-house and sundry canal locks and other tangible property, an injunction was sustained, the court holding that, in the absence of a statute, neither the franchise of the company, nor any lands or works essential to the enjoyment of the franchise, and which could not be separated from it without destroying or impairing its value, could be sold on execution. *Gue v. Tide Water Canal Co.*, 24 How. 257; *Covington Drawbridge Co. v. Shepherd*, 21 How. 112.

In a recent case, in which it appeared that a contractor had recovered a judgment against a railroad company, under which the "right of way to the railroad, so far as the right of way has been obtained, and all appurtenances belonging to said railroad," were sold by the sheriff and conveyed to the purchaser, the supreme court of the United States held the sale void, saying, in effect, that the company had no estate in its right of way capable of being sold on execution on a judgment at law, apart from its franchise to own and operate a railroad; that what the company acquired was merely an easement in the land to enable it to discharge its function of making and maintaining a public highway, the fee of the soil remaining in the grantor. Moreover, the court said, in substance, that it would be clearly violative of the policy of the state under whose laws the railroad company had been organized, to permit a private individual to seize and appropriate, by means of an execution sale, the right of way which had been acquired by the railroad company in pursuance of the pur-

poses for which it was organized. *East Alabama R. W. Co. v. Doe*, 114 U. S. 340; *Freeman Ex.* (2d ed.), § 179.

"It may be considered as settled that a corporation can not lease or alien any franchise or any property necessary to perform its obligations and duties to the state without legislative authority." *Black v. Delaware, etc., Canal Co.*, 22 N. J. Eq. 130-399; *Thomas v. Railroad Co.*, 101 U. S. 71.

Although a corporation, in respect to its capital, may be private, it may have been created, nevertheless, to accomplish objects in which the public have a direct concern, and its authority to acquire and hold property may have been conferred upon it in order that these objects might be consummated. In such a case the corporation takes its franchise, together with such property as the statute enables it to acquire by the exercise of the power of eminent domain, as a trust from the state, and it can neither alien the one nor the other without special authority, nor can they be seized and sold by any adverse process against it, unless express provision to that end has been made by statute. *Stewart's Appeal*, 56 Pa. St. 413; *Richardson v. Sibley*, 11 Allen 65.

Accordingly it was held that a corporation organized for the purpose of introducing water into a town for the accommodation of the inhabitants was, in a certain sense, a corporation for public purposes, and that its buildings and appendages necessary for carrying on its operations were not subject to sale in the process of enforcing a mechanic's lien taken thereon. *Foster v. Fowler*, 60 Pa. St. 27.

"For the sake of the public, whatever is essential to the corporate functions shall be retained by the corporation. The only remedy which the law allows to creditors against property so held is sequestration. And that remedy is consistent with corporate existence, whilst a power to alien, or liability to a levy and sale on execution, would hang the existence of the corporation on the caprices of the managers or on the mercy of its creditors." *Plymouth R. Co. v. Colwell*, 39 Pa. St. 337 (80 Am. Dec. 526).

While it is true that "the franchise to be a corporation is not a subject of sale and transfer unless the law, by some positive provision, has made it so, and pointed out the modes in which such sale and transfer may be effected;" and while the authorities abundantly justify the statement that property acquired and held by a corporation for the exclusive purpose of enabling it to accomplish the purposes of its creation can not, without like authority, be either directly or indirectly alienated, it does not follow that the creditors of such a corporation are remediless. 1 *Freeman Executions*, § 179.

Railroad corporations may sell or mortgage personal property, and the better view of the subject seems to be, that the corporation's right voluntarily to alienate property, and the creditor's power to subject it to the payment of corporate debts, stand upon the same footing. *Coe v. Columbus, etc., R. Co.*, 10 Ohio St. 372 (75 Am. Dec. 518).

As has been said, there is a distinction between the road and structures immediately connected therewith, and appliances afterwards obtained for the purpose of operating the road. "The interest or right



of way in the land required for the construction of the road, the timber and iron of the track, and the depots and structures for the supply of water and the like, are said to be part of the realty; and the road is not regarded as so constructed and prepared for use until such things are affixed." But when the road is thus constructed and prepared for use, locomotives, cars and other articles and materials, some of which are consumed in the use, are requisite, and the conclusion is well supported that these, when not in actual use, are liable to seizure and sale for the payment of debts. *Boston, etc., R. Co. v. Gilmore*, 37 N. H. 410 (72 Am. Dec. 336); *Pierce v. Emery*, 32 N. H. 484; *Coe v. Columbus, etc., R. Co.*, *supra*.

The seizure and sale of such property does not confer any right in the franchise of the corporation or to any of the privileges of the corporation. It is analogous to the case in which it appeared that the copyright of a map had been acquired under the act of congress, and the copper-plate engravings of the author had been seized and sold on execution; it was held that the intangible right to strike off and sell copies of the map was not sold. *Stephens v. Cady*, 14 How. 528.

In all those cases in which the owner of an intangible right, such as letters-patent and the like, might himself voluntarily assign it, although property of that description is not capable of being seized and sold on account of its incorporeal nature, it may, nevertheless, be subjected to the payment of the owner's debt by a bill in equity. *Ager v. Murray*, 105 U. S. 126

A court of equity may by its decree compel the owner to execute an assignment of letters-patent, because he is himself possessed of the power to assign. But in the absence of a statute authorizing it, a court of equity can not compel a railroad corporation to transfer its franchise or such property as is essential to the exercise of its corporate obligations, because, in the absence of such authority, the corporation could not itself voluntarily alienate or assign its property of that description.

The plaintiff in the present case acquired a mere statutory lien upon so much of the roadbed as he had constructed. The statute provides that the lien may be foreclosed, but it makes no provision for the sale of the franchise, or of the road as an entirety, or of anything that would in effect destroy or impair the use of the franchise.

The statutes regulating the construction and operation of railroads within the state plainly contemplate that the power to condemn lands and construct and operate railroads shall be confided to railroad corporations. There is no provision by which an individual citizen may condemn land for railroad purposes, nor is it contemplated that lands condemned and used for such purposes may afterwards be sold out on execution or by order of the court, and become the property of an individual, so long as the corporation is not dissolved and continues in the use of its franchises and property. The statute, unlike that which authorizes railroad companies to execute mortgages on their property and franchises, gives the contractor a lien, and nothing more.

As it appears in the present case that the debt remains unpaid, the



lien affords the basis for the exercise by a court of chancery of its flexible jurisdiction to coerce payment of the debt. The legislature doubtless deemed it the wiser course to leave the method of coercing payment in each case to the court, rather than to prescribe a method which might be suited to one case and not to another. While the corporation is solvent, with property and officers and agents, subject to the order and process of the court, within the state, a court of chancery can not be without expedients for coercing payment out of any money or property which the corporation itself might have applied to that purpose.

We know judicially that the Louisville, New Albany and Chicago Railway Company has hundreds of miles of railroad in operation in the state of Indiana. There is no suggestion that the corporation is insolvent. It has, aside from its franchise and fixed property, perhaps many thousands of dollars' worth of property within the state which is subject to seizure and sale; besides, it has many financial officers and agents in the state who receive daily thousands of dollars for the corporation. All these are subject to the order and process of the court. This is the extent to which the court can go until it appears that the corporation is insolvent and unable to pay its debts or meet its current obligations and liabilities—unable, in fact, longer to discharge the duties resting upon it as a corporation. In such a case, doubtless, a court of chancery would have the power to take possession of the corporate property by means of a receiver, and wind up the corporation and sell its property. Upon that subject we decide nothing until a case arises.

The conclusion of the whole matter in the present case is, that the order of the circuit court directing the railroad to be sold as an entirety, together with all its franchises, privileges and immunities thereto, was in excess of the power of the court. So far as cases relied on seem to support a contrary doctrine from that above enunciated, they are not deemed applicable to the facts in the present case. *Dayton, etc., R. R. Co. v. Lewton*, 20 Ohio St. 401; *Railroad Co. v. James*, 6 Wall. 750.

The justice of the case requires that, to the extent that the decree of the court orders the sale of the railroad of the Louisville, New Albany and Chicago Railway Company, as in the decree specified, including its franchises, privileges and immunities connected therewith, it should be modified and reversed with the costs of this appeal. So far as the decree orders and adjudges that the above named railroad company pay the plaintiff the sum therein named, it is affirmed, with leave to take such further steps, not inconsistent with this opinion, as may be deemed necessary to coerce payment of the judgment.

*Note.* See, 1825, *Ammant v. Turnpike Road*, 13 S. & R. 210, 15 Am. Dec. 593, note 595, 596; 1845, *Susquehanna Canal Co. v. Bonham*, 9 Watts & S. 27, 42 Am. Dec. 315; 1855, *Baltimore & O. R. v. Gallahue's Admr.*, 12 Gratt. (Va.) 655, 65 Am. Dec. 254; 1858, *Boston, etc., R. v. Gilmore*, 37 N. H. 410, 72 Am. Dec. 336 (rolling stock may be taken on execution); 1860, *Gue v. Canal Co.*, 24 How. 257; 1861, *Plymouth R. Co. v. Colwell*, 39 Pa. St. 337, 80

Am. Dec. 526; 1892, Overton Bridge Co. v. Means, 33 Neb. 857, 29 Am. St. Rep. 514; 1893, Gardner v. Mobile, etc., R., 102 Ala. 635, 48 Am. St. Rep. 84; 1895, Reynolds v. Reynolds Lumber Co., 169 Pa. St. 626, 47 Am. St. Rep. 935 (property of purely private corporation may be taken); 1898, Risdon Iron Works v. Citizens' Tr. Co., 122 Cal. 94, 68 Am. St. Rep. 25 (rolling stock may be taken on execution); 1900, State v. Turnpike Co., — N. J. —, 46 Atl. Rep. 569.

Compare §§ 308, 309, 310, *supra*.

**Sec. 654.** 3. In equity. Theories:

(a) Assets are a trust fund for creditors.

**JOSHUA B. WOOD AND OTHERS v. JEREMIAH DUMMER AND OTHERS.**<sup>1</sup>

1824. IN THE CIRCUIT COURT OF THE UNITED STATES. 3 Mason (U. S. Circuit) Rep. 308-323.

Bill in equity brought by the plaintiffs, as holders of the bank notes of the Hallowell and Augusta Bank, against the defendants, as stockholders in the same bank, for payment of the same notes upon the ground of an asserted fraudulent division of the capital stock of the bank by the stockholders. The defendants put in answers, denying the fraud, but admitting the division of the capital stock, etc., and denying the plaintiff's title to relief.

[The bank was incorporated in 1804, with a capital stock of \$200,000, in shares of \$100 each; its charter expired in 1812, but for purpose of enabling such banks to settle up their affairs they were continued in existence until 1819. In January, 1813, the stockholders declared a dividend of 50 per cent., and in October, 1813, another of 25 per cent. out of the capital of the company; 25 per cent. of the stock was never paid in, but stock notes were given therefor; \$90,000 were due the corporation from insolvent directors, so that the bank was without funds to pay debts (then amounting to more than \$90,000), after the above dividends were paid to the shareholders. Plaintiffs were owners of \$29,000 of the notes of the bank, which in 1814 were presented for payment, and payment refused.]

STORY, J. \* \* \* The case is full of difficulties. The bill is drawn in a very loose and inartificial manner. It proceeds principally upon the grounds of a gross over-issue of bank notes and other violations of the charter, and of a fraudulent dividend by the stockholders with a knowledge of their insolvency; grounds which are denied by the answers, and are not in the slightest degree established in the proofs. It does not directly proceed upon the ground that the defendants hold a trust fund applicable to the payment of the debts of the corporation; but leaves this to be picked up in fragments by a minute analysis of the bill. I pass, however, over these objections for the purpose of considering that which is the principal point argued

<sup>1</sup> Statement abridged, and part of opinion omitted.

in the cause, whether the capital stock in the hands of the stockholders is liable to the payment of the debts of the bank.

It appears to me very clear upon general principles, as well as the legislative intention, that the capital stock of banks is to be deemed a pledge or trust fund for the payment of the debts contracted by the bank. The public, as well as the legislature, have always supposed this to be a fund appropriated for such purpose. The individual stockholders are not liable for the debts of the bank in their private capacities. The charter relieves them from personal responsibility, and substitutes the capital stock in its stead. Credit is universally given to this fund by the public as the only means of repayment. During the existence of the corporation it is the sole property of the corporation, and can be applied only according to its charter, that is, as a fund for payment of its debts, upon the security of which it may discount and circulate notes. Why, otherwise, is any capital stock required by our charters? If the stock may, the next day after it is paid in, be withdrawn by the stockholders without payment of the debts of the corporation, why is its amount so studiously provided for and its payment by the stockholders so diligently required? To me this point appears so plain upon principles of law, as well as common sense, that I can not be brought into any doubt that the charters of our banks make the capital stock a trust fund for the payment of all the debts of the corporation. The bill-holders and other creditors have the first claims upon it; and the stockholders have no rights until all the other creditors are satisfied. They have the full benefit of all the profits made by the establishment, and can not take any portion of the fund until all the other claims on it are extinguished. Their rights are not to the capital stock but to the residuum after all demands on it are paid. On a dissolution of the corporation the bill-holders and the stockholders have each equitable claims, but those of the bill-holders possess, as I conceive, a prior exclusive equity. The same doctrine has been recognized by the supreme court of Massachusetts, in *Vose v. Grant* (15 Mass. Rep. 505, 517, 522), and *Spear v. Grant* (16 Mass. Rep. 9, 15).

If I am right in this position, the principal difficulty in the cause is overcome. If the capital stock is a trust fund, then it may be followed by the creditors into the hands of any persons having notice of the trust attaching to it. As to the stockholders themselves, there can be no pretense to say that, both in law and fact, they are not affected with the most ample notice.

The doctrine of following trust funds into the hands of any persons who are not innocent purchasers, or do not otherwise possess superior equities, has been long established. Lord Redesdale, in *Adair v. Shaw* (1 Sch. & Lef. 243, 262), lays it down in very broad terms. He says: "If we advert to the cases on this subject, we shall find that trusts are enforced not only against those persons who rightfully are possessed of the trust property as trustees, but also against all persons who come into possession of the property bound by the trust with notice of the trust; and whoever comes so into possession is considered

as bound, with respect to that special property, to the execution of the trust." And a very strong recognition, as well as application of the principle, will be found in *Taylor v. Plumer* (3 Maule & Selw. 562, 574), even in a court of common law. Upon this ground, assets disposed of by executors by misapplication, or existing in the hands of debtors, where the executor is insolvent, or there is collusion, are often reached in favor of creditors as a trust fund. *Hill v. Simpson* (7 Vez. 152), and the cases there cited fully illustrate this position. See, also, *Moses v. Murgatroyd*, 1 Johns. Ch. Rep. 119; *Dexter v. Stewart*, 7 Johns. Ch. Rep. 52; *Shepherd v. McEvers*, 4 Johns. Ch. Rep. 136; *Long v. Majestre*, 1 Johns. Ch. Rep. 305; *Riddle v. Mandeville*, 5 Cranch 322; *Russell v. Clark's Executors*, 7 Cranch 69.

The cases of partnership furnish, also, a pretty strong analogy. There, in equity, partnership funds will be followed in favor of creditors into the hands of third persons. It is true, that, as the master of the rolls said in *Campbell v. Mullett* (2 Swanston R. 550, 575), the equities of creditors are to be worked out through the medium of the partners. They have no lien, but something approaching to a lien, which courts of equity will regard and enforce, in all cases, where superior rights, which ought to be protected, do not intervene. See, also, *Ex parte Ruffin*, 6 Vez. 119, 127; *Ex parte Fell*, 10 Vez. 347; *Ex parte Williams*, 11 Vez. 3; *Ex parte Harris*, 1 Madd. R. 313; *Ex parte Kendall*, 17 Vez. 514, 526; *Murray v. Murray*, 5 Johns. Ch. Rep. 60; *Ex parte Lodge & Fendall*, 1 Vez. Jr. 166; *Taylor v. Fields*, 4 Vez. 396; *Young v. Keighly*, 15 Vez. 557. It is not, however, necessary to search for analogous cases; for upon the plain import of the charter, the capital stock is a trust fund for creditors, and the stockholders, upon the division, take it subject to all equities attached to it. They are, to all intents and purposes, privies to the trust, and receive it *cum onere*. \* \* \*

The next consideration is whether the bill makes out a case, which upon the facts proved or admitted, entitles the plaintiffs to relief. I have already adverted to the loose structure of the bill. It primarily charges the case as a case of fraud; that is now abandoned. If it can stand at all, it must be simply on the fact that the defendants have the funds in their possession. That alone could not entitle the parties to relief without allegations of insolvency on the part of the corporation or of the non-existence of other funds. Now, the bill does not allege that the corporation is insolvent, nor that it is dissolved, nor that there is no other corporate property out of which the debts can be paid. These are extraordinary omissions, and if there had been a demurrer to the bill, it would be difficult for the court to have strained hard enough to support it. But these defects are in some degree helped by the answers, which admit the insolvency of the corporation, and show that in fact no sufficient funds for payment of its debts are in existence, independent of the capital stock. \* \* \*

The exception as to parties ranges itself under this head. There is no allegation in the bill that the old corporation is defunct, so as to dispense with its being made a party. The answers do not deny that it yet

has a legal existence, and, therefore, afford no help to cure the defect. Now, if in existence, nothing can be more clear than that it ought to have been made a party to the bill. It is the original debtor; its funds are to be applied in payment of debts, and it would be wrong to touch those funds without the most plenary proofs that the debts were due, and the corporation had no defense. \* \* \*

This difficulty in point of averment and proof (for the fact of dissolution is notorious to all) may, however, as I think, be overcome. The acts of the legislature creating the bank, and continuing its existence for a limited time, are made part of the bill; and as a prolonged existence can not be presumed, and is not asserted in the answers, the court must take it to be true that the corporation expired by the legislative limitation, antecedent to the filing of the bill. Upon the clearest principles it can not be necessary to make a non-existing corporation a party.

But, then, it is argued that no decree ought to be made without making all the stockholders parties to the bill, for all are liable to contribution. I agree that if proper parties are not made, the defendant may demur to the bill, or state it by plea or answer, or may object to a decree at the hearing, or even obtain a reversal, in some cases, after a decree. Whenever, taken either by demurrer, or plea, or answer, or at the hearing, the court, if the objection is well founded, is not bound to dismiss the bill, but may retain it, giving leave to make new parties. The subject as to who are necessary parties, and when they may be dispensed with, was a good deal discussed by the court in delivering its judgment in *West v. Randall* (2 Mason R. 181, 190, etc.). The principal cases are there collected and commented on. The general rule is that all persons materially interested, either as plaintiffs or defendants, are to be made parties. There are exceptions, just as old and as well founded as the rule itself. Where the parties are beyond the jurisdiction, or are so numerous that it is impossible to join them all, a court of chancery will make such a decree, as it can, without them. Its object is to administer justice, and it will not suffer a rule, founded in its own sense of propriety and convenience, to become the instrument of a denial of justice to parties before the court who are entitled to relief. What is practicable, to bring all interests before it, will be done. What is impossible or impracticable, it has not the rashness to attempt, but it contents itself with disposing of the equities before it, leaving, as far as it may, the rights of other persons unprejudiced. In respect to the exception on account of the numerousness of parties, the question has been discussed and acted upon in many cases, particularly in *Chancey v. May* (Prec. Ch. 592), *Leigh v. Thomas* (2 Vez. Sr. 312), *Lloyd v. Loaring* (6 Vez. 773), *Adair v. The New River Company* (11 Vez. 429), *Good v. Blewitt* (13 Vez. 397), and *Cockburn v. Thompson* (16 Vez. 320). The result of the whole cases is that where the parties are so numerous that it is inconvenient or impracticable to bring all before the court, the rule, which is founded on the consideration of public good, shall not be applied, since it would defeat the purposes of justice. \* \* \*



Upon the whole, my opinion is, that the objection of the want of sufficient parties can not be maintained. We may then proceed to the merits of the defense as disclosed in the answers. One ground there taken is, that the demands of the plaintiffs respectively are barred by the statute of limitations. But this bar to a decree can not upon the facts be sustained. The rights of the plaintiffs accrued as against the defendants within six years; for until a refusal of payment by the bank of its notes, followed by an inability to discharge them, there was no cause of proceeding in equity against the defendants. There is no positive bar to suits in equity, but whenever any limitation is adopted it is ordinarily regulated by analogy to the common law. Here the claim is against a trust fund in the hands of the defendants; and in cases, not of constructive, but of express trusts, so long, at least, as they are not encountered by an adverse possession and denial of right, the statute of limitations does not begin to run. I should have very great difficulty in allowing a bar of the statute of limitations to operate in a case of this nature, unless where the circumstances of negligence on one side and of positive denial of right on the other were very cogent. \* \* \*

The only other ground suggested as a defense by the defendants is that they have been guilty of no fraud, and that the division of the capital stock was an act authorized by law; and there is no equity to relieve the plaintiffs by throwing the loss on the stockholders. The answer to this argument, for such it is, has already been given. The stockholders have no right to anything but the residuum of the capital stock, after payment of all the debts of the bank. The funds in their hands, therefore, have an equity attached to them in favor of the creditors, which it is against conscience to resist. To be sure the plaintiffs might, if their bill had been properly framed, have shown a much stronger case for equity, and might have shown due diligence in attempting to enforce their rights. I allude to the known facts of the various suits at common law, some of which have been cited at the bar, and others brought to this court for decision, in which great efforts have been made to obtain a remedy at law, by the bill-holders, without success.

The next question is, what sort of decree the plaintiffs are entitled to. Are they entitled to a decree, to the full amount of the dividends received by the defendants respectively, towards payment of the debts due from the bank to them, or are they entitled only to a *pro rata* payment out of that dividend, in the proportion which the stock held by the defendants bears to the whole capital stock?

The bill does not allege that the other stockholders, who have received dividends, are insolvent or out of the jurisdiction of the court. Nor does it state what the amount of the debts due from the bank to the bill-holders, or others, is. It would have been desirable, as far as it was practicable, that all the other creditors, who had a common interest, might have been brought before the court. But neither party has urged it, or waived any formal objection to the introduction of them. The court, therefore, in proceeding to do equity to those before it,



must take care that it is not the instrument of injustice to others who are not represented. *Non constat*, if the whole fund is taken from the defendants in favor of the plaintiffs, that there will remain any solvent stockholders, from whom the other creditors can claim any share. \* \* \*

I have come to the conclusion that our duty is best performed by holding the plaintiffs entitled to a decree, that the defendants pay out of the dividends of the capital stock received by them so much of the debts due to the plaintiffs as the number of shares held by them in the same capital stock (viz., 320 shares) bears to the whole number of shares in the capital stock (viz., 2,000 shares). \* \* \*

*Decree accordingly with costs.*

*Note.* As to trust-fund doctrine, see note 54 Am. St. Rep. 65; 3 Am. St. Rep. 806; 1671, Salem v. Hamborough Co., 1 Cas. Ch. 204; 1819, Vose v. Grant, 15 Mass. 505; 1822, Slee v. Bloom, 19 Johns. (N. Y.) 456, *supra*, p. 881; 1853, Curran v. Arkansas, 15 How. 304; 1859, Ogilvie v. Knox Ins. Co., 22 How. 380; 1873, Sawyer v. Hoag, 17 Wall. 610; 1875, Upton v. Tribilcock, 91 U. S. 45; 1875, Sanger v. Upton, 91 U. S. 56; Webster v. Upton, 91 U. S. 65; also, 95 U. S. 665; 98 U. S. 328; 1879, Hatch v. Dana, 101 U. S. 205, *infra*, p. 1965; 1879, Hastings v. Drew, 76 N. Y. 9; 1880, County of Morgan v. Allen, 103 U. S. 498; 1880, Hawley v. Upton, 102 U. S. 314; 1881, Scovill v. Thayer, 105 U. S. 143, *infra*, p. 1907; 1885, Thompson v. Reno Sav. Bk., 19 Neb. 103, 3 Am. St. Rep. 797, note 806; 1886, Coit v. Gold Amal. Co., 119 U. S. 343; 1888, Morrow v. Iron Co., 87 Tenn. 262; 1889, Rouse v. Bank, 46 Ohio St. 493, *supra*, p. 1819; 1890, First Nat'l Bk. v. Gustin, etc., Bk., 42 Minn. 327; 1891, Eylton Land Co. v. Birmingham, etc., Co., 92 Ala. 407, 25 Am. St. Rep. 65; 1891, Camden v. Stuart, 144 U. S. 104; 1893, Hollins v. Brierfield Coal & I. Co., 150 U. S. 371; 1893, Lyons-Thomas Hdw. Co. v. Stove, etc., Co., 86 Tex. 143, 22 L. R. A. 802; 1896, Buck v. Ross, 68 Conn. 29, 57 Am. St. Rep. 60; 1896, In re Brockway Mfg. Co., 89 Me. 121, 56 Am. St. Rep. 401; 1897, Memphis Barrel, etc., Co. v. Ward, 99 Tenn. 172, 63 Am. St. Rep. 825; 1897, Cook v. Moody, 18 Wash. 114, 63 Am. St. Rep. 872; 1898, Van Cleve v. Berkey, 143 Mo. 109, 42 L. R. A. 593; 1899, Crofoot v. Thatcher, 19 Utah 212, 75 Am. St. Rep. 725; 1903, Shields v. Hobart, 172 Mo. 491, 95 Am. St. R. 529. See, also, following cases and notes.

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Sec. 655. Same. (b) Assets are not a trust fund; liability based on fraud.

O'BEAR JEWELRY CO. ET AL. V. VOLFER & CO. ET AL.<sup>1</sup>

1894. IN THE SUPREME COURT OF ALABAMA. 106 Ala. Rep. 205, 229; 54 Am. St. Rep. 31.

[Bill in equity by Volfer & Co., judgment creditors of the jewelry company, a corporation, four of its stockholders, its assignee (Johnston) for benefit of creditors, and the Alabama National Bank, alleging that the shareholders named organized the company, subscribed for its stock, but either paid nothing for it, or paid by the transfer of property at an excessive and fraudulent over-valuation, known to be

<sup>1</sup> Statement abridged; part of opinion of McClellan, J., and all of opinion of Coleman, J., omitted.

such, and fraudulently accepted by the company as full payment; that the company's property had been destroyed by fire, and the company had become insolvent; that the property was insured to the extent of \$7,000, and that the policy had been turned over to the bank to secure it a preference in the payment of a claim of \$2,500 due the bank; that the bank collected the \$7,000 due under the policy, paid itself the \$2,500, and "paid the balance to the persons who composed the corporation, or to some of them, or for their personal account;" that the corporation had also confessed a judgment to the amount of \$1,750 in favor of the bank, and immediately thereafter, on the same day, made an assignment for the benefit of creditors; the bill asked for a receiver, and that the shareholders be required to pay in full for their stock, less what had been paid; that the bank be required to pay back the amount received under the judgment, and any sum, over and above its share, collected on the insurance policy; that the assignee be required to file an account and pay over any sums in his hands to the receiver; and "that all the assets be brought together to be administered for the equal benefit of all the creditors of the corporation," on the ground "that the entire assets of said corporation constitute a trust fund for creditors, and that all persons who in anywise knowingly participate in the unlawful appropriation of said trust fund or any part thereof will be required in equity to restore the same." The bank and one of the shareholders demurred for misjoinder of parties defendant, some of whom had no connection with many of the alleged transactions, and multifariousness in joining claims against shareholders for unpaid subscriptions, and against the bank for money alleged to be improperly paid to it, and to set aside an alleged fraudulent disposition of property. Demurrers were overruled and an appeal taken.]

MCCLELLAN, J. \* \* \* The respondents, by their demurrers, insist that said assets do not constitute a trust fund in the sense necessary to the maintenance of the bill, exhibited, as it is, against parties who have nothing, and are not chargeable with any wrong, in common, but whose acts, claims and attitudes in respect of and toward the corporation are entirely distinct and independent; and hence they say that the bill is multifarious. And in the arguments submitted in this court the decree below is attempted to be supported solely and expressly upon this theory of the spoliation of a trust estate. So that the main, if not only, question presented on this appeal is whether the assets of an insolvent corporation constitute a trust fund for its creditors in the proper and essential meaning of those terms.

This whole idea, that the property of insolvent corporations is held by them in trust for creditors—is a trust estate in their hands—and to be administered by chancery as such, originated in a *dictum* of Judge Story, in *Wood v. Dummer*, 3 Mason 308. It had no existence at common law, and has none to this day in the law of England; but is distinctly a creation of some courts in this country, and known in jurisdictions where it obtains as the "American doctrine." This court has quite recently adopted it, and held, in the cases of *Corey v. Wads-*

worth, 99 Ala. 68, Goodyear Rubber Co. v. Scott & Co., 96 Ala. 439, and Gibson v. Trowbridge Furniture Co., 96 Ala. 357, that the assets of an insolvent corporation are impressed with a trust in the hands of the company, in favor of its creditors first, and then in favor of its stockholders. The present writer dissented from the opinion and conclusion of the court in each of those cases. To his mind there is nothing clearer in principle than the proposition that the property of a corporation, solvent or insolvent, bears identically the same relation to the creditors of such corporation as the property of an individual or copartnership, solvent or insolvent, sustains to the creditors of the individual or partnership; and is or is not to be impressed with a trust character upon the same circumstances and under the same conditions in the first case as in the latter two. Within the limits of its charter, every corporation authorized to hold and dispose of property at all, is entitled, and this generally by the very terms of the statute creating it, to hold and dispose of it as a natural person might hold and dispose of it under the laws of the land. \* \* \*

I can not, upon well-settled and elementary general principles and definitions, see my way to an acceptance of this so-called doctrine. All trusts are of two kinds: express and implied. It is, of course, nowhere pretended the relations between an insolvent corporation and its creditors constitute an express trust. All implied trusts are of two kinds: resulting and constructive. "Resulting trusts," says Mr. Pomeroy, "arise where the legal estate is disposed of or acquired, not fraudulently or in violation of any fiduciary duty, but the intent in theory of equity appears or is inferred or assumed from the terms of the disposition, or from the accompanying facts and circumstances, that the beneficial interest is not to go with the legal title." 1 Pom. Eq. Jur., § 155. And they are said to arise under the following several states of fact: (1) Where the purchaser of an estate pays the purchase-money, and takes title in the name of a third person; (2) where a person standing in a fiduciary relation uses fiduciary funds to purchase property, and takes the title in his own name; (3) where an estate is conveyed upon trusts which fail, either in whole or in part, or are not declared, or are illegal; and, (4) where a conveyance is made without consideration, and it appears from the circumstances that the grantee was not intended to take beneficially. 10 Am. & Eng. Encyc. of Law, pp. 4, 5. It requires no discussion to the demonstration of the impossibility of referring this "American doctrine" of trusts for corporation creditors to the head of resulting trusts.

All constructive trusts are of three kinds, or arise from one or the other of three conditions of fact: *First*, trusts arising from actual fraud; *second*, trusts which arise from constructive fraud; and, *third*, trusts that arise from some equitable principle independent of the existence of fraud. 10 Am. & Eng. Encyc. of Law, p. 60. As there is no fraud, actual or constructive, involved in the naked fact that a corporation is insolvent—has creditors which it is without assets to pay in full—and this fact is the base for all the superstructure of this

doctrine of trust for its creditors, it can not be conceived, and, I suppose, has never been contended, that such trust is referable to either the first or second heads of constructive trusts. And it is the conclusion of so high an authority as Mr. Pomeroy, that the third classification of constructive trusts stated above has no existence dissociated from actual and constructive fraud. It is his opinion, "that all instances of constructive trusts properly so called may be referred to what equity denominates fraud, either actual or constructive, as an essential element, and as their final source. Even in that single class where equity proceeds upon the maxim that an intention to fulfill an obligation should be imputed, and assumes that the purchaser intended to act in pursuance of his fiduciary duty, the notion of fraud is not involved, simply because it is not absolutely necessary under the circumstances; the existence of the trust might in all cases of this class be referred to constructive fraud. This notion of fraud enters into the conception in all its possible degrees. Certain species of the constructive trusts arise from actual fraud; many others spring from the violation of some positive fiduciary obligation; in all the remaining instances there is, latent perhaps, but none the less real, the necessary element of that unconscientious conduct which equity calls constructive fraud." 2 Pom. Eq. Jur., § 1044. If this view be adopted the relation between an insolvent corporation and its creditors is excluded from every possible category of constructive trusts for the reason, or by virtue of the fact, that that relation involves no fraud whatever; and as that relation is, as I have seen, the sole ground for the doctrine of trusts in cases like this, the doctrine is unsound, unsupported in principle or reason, and should not be upheld by any court.

But if we adopt the view first stated above, that constructive trusts may arise by force of some equitable principle independent of the existence of fraud, actual or constructive, and which seems also to be the opinion of Mr. Perry (1 Perry on Trusts, § 168), the same conclusion is equally inevitable. Eliminating the element of fraud from the consideration there still remains as an essential predicate for the existence of a trust by construction of law, some unconscientious conduct on the part of the person to be held as trustee *in invitum*, or some unconscionable result through means or under circumstances which bring the transaction within some recognized title of equity jurisprudence, as, for instance, where a tenant in common buys in an outstanding term for his own benefit, he is trustee for his cotenant, and where a conveyance has been made through ignorance, accident or mistake, the grantee will be the trustee in a constructive trust for the grantor. Thus, wherever one is placed in such relation to another that he becomes interested with or for him in property or business, he is prohibited from acquiring rights in that property or business antagonistic to the person with whom he is associated, as, for illustration, if one partner, or other person occupying a fiduciary relation, renew a lease theretofore held by the partnership, or by the person renewing and another in confidential relation to him, in his own name and with

his own funds, he will be a trustee for his associate by construction of law. And so, where by accident, ignorance or mistake more land is embraced in a conveyance than was bargained and sold, a constructive trust arises in favor of the grantor for the excess. 10 Am. & Eng. Encyc. of Law, p. 80.

But in all these cases, in all cases of constructive trusts where it is said by some authorities chancery proceeds without regard to fraud, relief is granted upon some acknowledged ground of equitable jurisdiction, and administered by holding the wrong-doer to account as a trustee. There must be a confidential relation and unconscientious conduct on the part of one party to, and in abuse of, that relation, or there must be some ignorance, accident, mistake, or the like, against the unconscionable consequences of which equity will, on general principles, grant relief, else there can be no constructive trust.

That the relation of debtor and creditor is not of a confidential character there can, of course, be no doubt. It is absurd to say that the creation of that relation involves aught of accident, mistake or ignorance. That a debtor has property of his creditor which in equity and good conscience belongs to the creditor, because the debt contracted in its sale has not been paid, there is no warrant for saying. Equally unwarranted is the idea that in equity all the property of a debtor who has become insolvent belongs to the creditor, and is held by the debtor in trust for him. And this idea of *ownership* in the *cestui que trust* underlies the whole doctrine of trusts of every description. In all trusts the legal title is in one, the equitable ownership in another. A mere debt against one who has property, whether solvent or insolvent, is not ownership, nor is a right to charge a fund, or a lien upon it, the beneficial ownership of it. Confessedly the property and assets of a solvent corporation do not constitute a trust fund for its creditors. Can it be possible that the mere passing of a corporation from a state of solvency to a state of insolvency amounts to a declaration of an express trust for creditors, or to a resulting trust, upon the theory that title to the assets of the concern should have been made to the creditors? Or is it conceivable that this mutation from the one condition to the other does violence to a confidential relation which never existed, and hence is a constructive trust? Or that this mere change of inherent conditions is the vestiture in the corporation through the ignorance, or mistake of the creditor, or through mistake, or through fraud, of a greater title, or title to more property than was contemplated and intended, when before the change, confessedly, the corporation had the absolute and indefeasible title free from all trusts to all its property and assets, and when the change itself involves nothing of fraud, of abuse of fiduciary relations, of ignorance, or mistake or accident?

The learned judges who uphold this "American doctrine" may find something in these conditions of fact upon which to construct a trust, but I confess my utter inability to follow their arguments or to see with their eyes. Nothing is clearer to my humble judgment than that the insolvency of a corporation—the existence of a corporation



with property and debts, the property being insufficient to pay the debts—is not within any definition of any trust known to equity jurisprudence. The creditors of such corporation have the same rights against it as they have against an insolvent partnership, or an insolvent individual debtor, and no other or more. They do not at law or in equity own the property of the one or the other; but the property of each is a fund for the payment of debts in the sense that neither can give it away, or dispose of it, with intent to hinder, delay or defraud creditors. The property of the individual can not be appropriated to his own use to the exclusion of his creditors under any cover whatever. The property of the partnership can not be appropriated to the personal use of the partners, or in payment of the debts of the individuals composing the firm, to the exclusion of partnership creditors under any pretense whatever. And so the property of the corporation can not be diverted to the use of the stockholders to the exclusion of creditors under any circumstances whatever. The powers and limitations upon the powers of an insolvent corporation to deal with its property are precisely the same in all essentials as the powers and limitations upon the powers of insolvent individuals and insolvent partnerships.

The estate of the debtor in each class is essentially the same—the corporation, no less than the individual and the partnership, is at law and in equity the owner of its property. The rights, remedies and estates of creditors of each are also the same. They do not *own* the property of their corporation debtor, or any interest in it, in equity or at law, any more than they own the property of their individual or partnership debtor. Their right against each is the same—to have their debts paid out of the property, but this right is not that of a *cestui que trust*, but whether the property is corporate or individual or partnership, it is the right of a creditor simply. Confessedly, even this right may be defeated as to any particular creditors by a sale of the property in payment of another creditor, or by its being taken on execution in favor of another, or even by its sale by the debtor—corporation, individual or partnership—to a third person, and this although such purchaser have notice of the insolvency of the debtor. All which, as I have seen, would be impossible if the property constituted a trust estate, with the corporation as trustee and the creditors as *cestuis que trust*, for in such case all who take with notice of the insolvency would take subject to the trust and themselves be held as trustees *in invitum*.

Not only are the rights of individual, partnership and corporation creditors the same against their insolvent debtors' estates, and each different in the same way from the rights of *cestuis que trust*, but the remedies of a corporation creditor, in the absence of a statute, are precisely those of a creditor of an individual or partnership. The remedy of each class of creditors may, upon a given state of facts, be in equity, but when this is so, it is not because of any supposed trust, but upon some recognized ground of equity jurisprudence, as where the



debtor has fraudulently transferred his or its property, and chancery is invoked to set aside the transfer and subject the property. And when chancery has thus assumed jurisdiction, it will administer the estate for the equal benefit of all creditors before it, and to that end the court becomes a sort of trustee *sub modo*, in the administration of the property, but not with any reference to the character of the estate, as being held in trust or otherwise, before and at the time jurisdiction attached.

Not all the publicists and courts in this country, nor the ablest of them, countenance this so-called American doctrine. Mr. Pomeroy expressly repudiates it. He says: "In applying this principle (of constructive trusts), care should be taken to distinguish between actual trusts and those relations which are only trusts by way of metaphor; between persons who are true trustees holding the legal title for a beneficial *owner*, and those who simply occupy a position which is analogous in some respects to that of a trustee. The use of these terms to designate relations and parties which have no essential element in common with actual trusts and trustees can only produce confusion and inaccuracy. \* \* \* There are certain relations which are spoken of as trusts, and as constituting a species of constructive trusts, but which are not, in any true and complete sense, trusts, and can only be called so by way of analogy or metaphor. Since they lack the element of fraud, they do not, in any view, properly belong to the division of constructive trusts. \* \* \* The survivors of a partnership are called trustees for the estate of the deceased partner, with respect to his share of the firm property. This expression is mostly metaphorical; there is certainly nothing in the relation resembling a constructive trust. Extending the analogy still further, courts regard partnership property, after an insolvency or dissolution of the firm, and in the proceeding for winding up its affairs, as a trust fund for the benefit of creditors, and the capital stock and other property of private corporations, especially after their dissolution, is treated as a trust fund in favor of creditors. These statements may be sufficiently accurate as strong modes of expressing the doctrine that such property is a fund sacredly set apart for the payment of partnership and corporation creditors, before it can be appropriated to the use of individual partners or corporators, *and that the creditors have a lien upon it* for their own security; but it is plain that no constructive trust can arise in favor of the creditors, unless the partners or directors, through fraud or a breach of fiduciary duty, wrongfully appropriate the property, and acquire the legal title to it in their own names, and thus place it beyond the reach of creditors through ordinary legal means." And in a note to the above text the learned author says: These "cases are not constructive trusts, and are mentioned simply for the purposes of completeness, and to distinguish between correct and mistaken conceptions." 2 Pomeroy's Eq. Jur., §§ 1044, 1045.

And the highest and ablest court in the land, the supreme court of the United States, has quite recently gone over this whole subject,

considered exhaustively all its own decisions and *dicta* upon it, and in an able opinion by Mr. Justice Brewer repudiated the idea that the property of an insolvent corporation is a trust fund or estate held by the corporation or its officers for creditors as *cestuis que trust*. Judge Brewer quotes the language of Judge Bradley in *Graham v. Railroad Co.*, 102 U. S. 148, to the effect that when a corporation becomes insolvent, a court of equity, at the instance of proper parties, "will then make its funds trust funds, which, in other circumstances, are as much the absolute property of the corporation as any man's property is his," and says of that case, that "all that it decides is that when a court of equity does take into its possession the assets of an insolvent corporation, it will administer them on the theory that they in equity belong to the creditors and stockholders rather than to the corporation itself." And he proceeds further on to say: "It is rather a trust in the administration of the assets after possession by a court of equity than a trust attaching to the property, as such, for the direct benefit of either creditor or stockholder;" and he concludes his opinion upon this subject as follows: "The same idea of equitable lien and trust exists to some extent in the case of partnership property. Whenever, a partnership becoming insolvent, a court of equity takes possession of its property, it recognizes the fact that in equity the partnership creditors have a right to payment out of those funds in preference to individual creditors, as well as superior to any claims of the partners themselves. And the partnership property is, therefore, sometimes said, not inaptly, to be held in trust for the partnership creditors, or, that they have an equitable lien on such property. Yet, all that is meant by such expressions is the existence of an equitable right which will be enforced whenever a court of equity, at the instance of a proper party and in a proper proceeding, has taken possession of the assets. It is never understood that there is a specific lien, or a direct trust.

"A party may deal with a corporation in respect to its property in the same manner as with an individual owner, and with no greater danger of being held to have received into his possession property burdened with a trust or lien. The officers of a corporation act in a fiduciary capacity in respect to its property in their hands, and may be called to an account for fraud, or sometimes even mere mismanagement in respect thereto; but as between itself and its creditors the corporation is simply a debtor, and does not hold its property in trust, or subject to a lien in their favor, in any other sense than does an individual debtor. That is certainly the general rule, and if there be any exceptions thereto they are not presented by any of the facts in this case. Neither the insolvency of the corporation, nor the execution of an illegal trust deed, nor the failure to collect in full all stock subscriptions, nor all together, gave to these simple contract creditors any lien upon the property of the corporation, nor charged any direct trust thereon." *Hollins v. Brierfield Coal and Iron Co.*, 150 U. S. 371, 381-386.

The supreme court of Minnesota, in an able opinion by Mitchell, J., also repudiates this idea that the property of an insolvent corporation is a trust fund. Of it it has this to say: "This 'trust-fund'

doctrine, commonly called the 'American doctrine,' has given rise to much confusion of ideas as to its real meaning, and much conflict of decision in its application. To such an extent has this been the case that many have questioned the accuracy of the phrase, as well as doubted the necessity or expediency of inventing any such doctrine. While a convenient phrase to express a certain general idea, it is not sufficiently precise or accurate to constitute a safe foundation upon which to build a system of legal rules. The doctrine was invented by Justice Story in *Wood v. Dummer*, 3 Mason 308, which called for no such invention, the fact in that case being that a bank divided up two-thirds of its capital among its stockholders without providing funds sufficient to pay its outstanding bill-holders. Upon old and familiar principles, this was a fraud on creditors. Evidently all that the eminent jurist meant by the doctrine was that corporate property must first be appropriated to the payment of the debts of the company before there can be any distribution of it among stockholders—a proposition that is sound upon the plainest principles of common honesty. In *Fogg v. Blair*, 133 U. S. 534, 541, it is said that this is all the doctrine means. The expression used in *Wood v. Dummer*, 3 Mason 308, has, however, been taken up as a new discovery which furnished a solution of every question on the subject. The phrase that 'the capital of a corporation constitutes a trust fund for the benefit of creditors' is misleading. Corporate property is not held in trust in any proper sense of the term. A trust implies two estates or interests—one equitable and one legal; one person, a trustee, holding the legal title, while another, as the *cestui que trust*, has the beneficial interest. Absolute control and power of disposition are inconsistent with the idea of a trust. The capital of a corporation is its property. It has the whole beneficial interest in it, as well as the legal title. It may use the income and profits of it, and sell and dispose of it, the same as a natural person. It is a trustee for its creditors in the same sense and to the same extent as a natural person, but no further." *Hospes v. Northwestern Manufacturing Co.*, 48 Minn. 174, s. c. 31 Am. St. Rep. 637, 641, 642. \* \* \*

I am impelled to the conclusion that the property of an insolvent corporation is not a trust fund or estate, accurately speaking, or in any sense other than that when the chancery court takes possession and control of such property upon some general principle of equity jurisdiction, wholly independent of any idea that the property constitutes a trust fund, it will be administered for the equal benefit of creditors. It follows that the bill can not stand against the demurrers for multifariousness unless that objection can be met upon some other consideration than the trust character of the corporation property and assets, which is alone and expressly, both in the averments of the bill itself and in the argument of counsel, relied on to support the decree overruling the demurrers. I do not think the objection can be met upon any other ground. There is no connection between several of the matters brought forward by the bill, and the defendants attempted to be charged in respect of some of these matters have no interest what-

ever in others. For instance: The Alabama National Bank did not participate in the wrongs committed upon the corporation in respect of the subscriptions to its stock by the O'Bears and Copeland, and it is not interested in the present effort to right those wrongs. Again, the bill seeks the settlement of the trust created by the assignment to R. D. Johnston and to compel the bank to pay into court money which it owed the corporation, or held belonging to the corporation, and paid over to the stockholders of the corporation, which constituted no part of and had no connection with the assignment to Johnston. And equally dissociated is the effort of the bill to have an accounting by the assignee from its purpose to collect unpaid subscriptions from stockholders. And so in respect of the purpose of the bill to have the judgment in favor of the bank declared a part of the assignment, and to have the bank refund the amount it received in satisfaction thereof, this claim is wholly foreign to the relief sought against the bank as to the insurance money paid to the O'Bears and Copeland, and also to the relief sought against the subscribers to the stock. In other words and in brief, the bill, in my opinion, stands upon the same plane in respect of multifariousness as if it had been filed against an insolvent individual debtor, who was wasting or fraudulently disposing of his property, and against his assignee for the benefit of creditors, a creditor to whom he had confessed judgment which his assignee had paid as a lien on the property assigned, against a person who, having assets of the insolvent debtor in his hands, had paid the same to third persons so they could not be reached by creditors, and against other persons who, in equity, owed money to the debtor defendant. In such case—and no more in this—there would be no relation or connection between the defendants, or the rights asserted against them respectively, either in the character of their wrongs or defaults, or in the character of the estate they had despoiled; and recovery against each would be had, if allowed at all, not upon any idea of conserving a fund which the court, because of its trust character, had the right to protect and restore, but solely as enforcing several money demands from several defendants in one and the same action, in which also the trustee in the assignment would be brought to account on considerations and in respect of matters with which the claims against some of the other defendants had no connection.

In preparing the foregoing opinion, the writer assumed to express his individual views only because of decisions of this court referred to above which take a different view as to the assets of an insolvent corporation being a trust fund. This opinion has now, however, been concurred in by my associates, and stands as the opinion of the court. The cases of *Corey v. Wadsworth*, 99 Ala. 68; *Goodyear Rubber Co. v. Scott & Co.*, 96 Ala. 439, and *Gibson v. Trowbridge Furniture Co.*, 96 Ala. 357, *supra*, in so far as they are inconsistent with the views and conclusion we now express, are overruled.

The decree overruling the demurrers for multifariousness is re-

versed, and a decree will be here entered sustaining said assignments of demurrer.

Reversed, rendered and remanded.

*Notes.* Assets are not a trust fund. See, 1826, Catlin v. Eagle Bank, 6 Conn. 233, *supra*, p. 1815; 1891, Handley v. Stutz, 139 U. S. 417, *infra*, p. 1923, and note, p. 1932; 1892, Hospes v. N. W. Mfg. & Car Co., 48 Minn. 174, *infra*, p. 1911; 1895, First Nat'l Bk. v. Dovetail, etc., Co., 143 Ind. 550, 52 Am. St. Rep. 435; 1895, Barrett v. Pollak Co., 108 Ala. 390, 54 Am. St. Rep. 172; 1897, Butler v. Harrison L., etc., Co., 139 Mo. 467, 61 Am. St. Rep. 464; 1897, Ames v. Heslet, 19 Mont. 188, 61 Am. St. Rep. 496; 1900, Hall v. Henderson, 134 Ala. 455, 63 L. R. A. 673.

See, also, *supra*, cases upon power to prefer creditors, with notes § 645, *et seq.*

#### Sec. 656. 4. Right to enjoin waste.

VICE-CHANCELLOR SIR W. PAGE WOOD IN KEARNS v. LEAF.  
ADELBERT v. KEARNS.<sup>1</sup>

1864. IN THE COURT OF CHANCERY. 1 Hem. & Mill. Rep. 681, on  
707-709.

[The plaintiffs were policy bonus-holders in the Argus Insurance Company. These policies provided that the funds or property of the company should, according to the provisions of the deed of settlement, be subject and liable to pay within one month after the required proof of death the sum assured, and the bonus policies also provided that the assured should, after the first five years, be entitled to share in 80 per cent. of the profits, according to the annual valuation. Afterwards the Argus Company entered into an agreement with the Eagle Insurance Company to transfer its business, good-will and property to that company, which was in turn to pay a certain sum and assume all the debts and obligations of the Argus Company. Plaintiffs brought their bill to enjoin the consummation of this transaction.]

Now, I apprehend that under these stipulations the policy-holders have no right to meddle with anything, wise or unwise, which the company may do in accordance with the deed. For example, if the company invest in a hazardous or even ruinous security, the policy-holders are not entitled to interfere. It would be extremely mischievous to allow such interference. Still, the conduct of the company might reach a point of absolute waste of the assets in contravention of the provision of the deed, at which the right of the policy-holders to intervene might be considered to arise. In the passage I have read, the Lord Justice, Turner, makes an express reservation of such a contingency; and it is no answer to appeal to the decision at common law, where it has been held that the company (in such a case) is under no contract to continue its business; because, what the policy-holders would insist on would only be that if the business were discontinued, they shall either be paid, or else the fund preserved to meet their claims when they might arise. The principle on which

<sup>1</sup> Statement abridged.



the plaintiff's case is founded here is, that the fund which was held out to him as his security, and to which he has himself contributed, shall not be misapplied contrary to the provisions of the deed. He says that he comes here to prevent a waste of the assets. His position is somewhat analogous to that of a person having a contingent debt against a testator's estate, who may come into this court to prevent the estate being paid away to legatees, or wasted or thrown away by executors. The argument for the company, as I understand it, goes this length, that the policy-holder is simply a contingent future creditor minus the personal remedy. If that were the whole of the contract, it would be very different from what persons who insured in the company must have supposed. They could not have imagined that it was to be in the power of the directors or the company to destroy all their interest under their policies, leaving them without redress until their policies should have matured by death. I certainly do not think that this is the conclusion to be drawn from the terms of the particular contract which I have to consider in this case. In my opinion, the plaintiff did acquire under that contract such a species of interest in the fund as would entitle him to interfere to save the property from being wasted contrary to the provisions of the deed. \* \* \*

I am now only dealing with the case of a policy-holder; and if the company had made an adequate provision for him by setting aside a proper fund, or in any other way, they might have arranged their affairs as they pleased, so far as he was concerned. But they made no provision of the kind. Handing over the whole concern to another company having extensive engagements of its own, is not making provision for liabilities. It is not enough that they find some other body willing to undertake their engagements. What is required is some provision made by the Argus, not the possibility of the contract being carried out by the Eagle. I should, therefore, have had no hesitation in granting an injunction to restrain this transfer if it had not been already annulled.

*Note. Accord:* Lord Justice Turner in, 1854, *Evans v. Coventry*, 5 De G., M. & G. (54 Eng. Ch.) \*911. See next case.

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## Sec. 657. Same.

### FOSTER v. BORAX COMPANY.

1899. IN THE HIGH COURT OF JUSTICE, CHANCERY DIVISION, AND IN THE SUPREME COURT OF JUDICATURE, COURT OF APPEAL. 80 L. T. Rep. (N. S.) 461 and 637.

The Borax Company, Limited, was formed on the 30th of November, 1887.

By its memorandum it was authorized to "form or assist in the formation of any subsidiary company." It proceeded to issue



£295,200 6 per cent. debentures, of which £11,400 worth were held by the plaintiff.

On the 22d of June, 1898, it was resolved to wind the company up voluntarily, and on the 8th of July, 1898, a scheme was arranged under which, instead of each £100 debenture, an A debenture of £50 and a B debenture of £50 should be issued to every existing debenture holder. There would thus be £147,600 worth of A debentures, which were to carry interest at 4 per cent., and £147,600 worth of B debentures, which were to carry interest at 6 per cent. The liquidation was to stop on the confirmation of the scheme.

By an agreement, made on the 29th of November, 1898, between the Borax Company, Limited, of the one part, and a trustee for a new company, to be called the Borax Consolidated Company, Limited, of the other part, the old company agreed to sell its assets for £320,000, to be paid £100,000 either in cash or debentures, at the option of the new company, £150,000 either in cash or cumulative preference shares, at the option of the new company, and £70,000 by the allotment of ordinary shares.

The capital of the new company was to be £1,400,000, divided into £800,000 worth of 5½ per cent. cumulative preference shares, and £600,000 worth of ordinary shares.

From the 29th of September, 1898, the old company was to be considered as carrying on business on behalf of the new company, and the old company was to engage in no further business, except for the benefit of the old company.

On the 9th of January, 1899, the sale was approved by the shareholders of the old company.

By an agreement made between the trustee for the new company in the agreement of the 29th of November, 1898, and H. E. Thomas, on behalf of the new company, it was provided (*inter alia*):

(4) Save as aforesaid all principal moneys and interest in respect of mortgages or other charges in the nature of mortgages in respect of such premises shall be paid and satisfied by the Borax Company, Limited.

Completion was to take place on the 29th of March, 1899, and the benefit of the agreement of the old company not to carry on business except for the benefit of the old company was assigned.

The plaintiff now sought to obtain an injunction to restrain the carrying out of the scheme.

NORTH, J. I must grant the injunction that is asked for. The matter is one of great importance, and one in which the party against whom I decide may desire to take the opinion of the court of appeal, and if this is going to be done, the sooner the better. I have heard arguments at great length, but prefer to give my decision at once, as what I ought to do seems to me reasonably clear. With reference to the question whether the proposed arrangement would be a sale or an amalgamation, it would in my opinion be a sale; but that does not in any way affect my decision. As far as regards the shareholders there is power either to sell the undertaking or to amalgamate. The short

ground on which I consider that I ought to grant the injunction is that what the company is doing is destroying the substratum of its existence, and the result is that the floating charge which the debenture-holders have on the whole assets attaches, and the company has no right, as against the debenture-holders, to part with the property.

(On appeal by defendants from this decision, before Lindley, M. R., Rigby and Collins, L. JJ.)

Their lordships said that if the money owing to the entire number of still dissentient debenture-holders, amounting in all to £16,900, were brought into court, the order of North, J., would be discharged, the costs to be costs in the action.

*Note.* See preceding case, and following case and note.

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Sec. 658. 5. To enjoin threatened wrong.

SHIPMAN, J., IN *LOTHROP v. STEDMAN*.

1875. IN THE SUPREME COURT OF ERRORS OF CONNECTICUT. 42  
Conn. Rep. 583, on 589.

[The American National Life Insurance Company was incorporated in Connecticut in 1866, the charter reserving the right to the legislature to alter, amend or repeal the same. In 1874 the insurance commissioners of the state reported to the legislature that the company had transferred its assets to another company, which had assumed the obligations of the former; that its liabilities were \$400,000 more than its assets, and that it had ceased to do business, whereupon the legislature repealed its charter, and directed the insurance commissioner to take charge of its assets and apply them to the credit of the policy-holders. The commissioner was about to do this when the plaintiffs, citizens of New York and policy-holders, brought their bill in equity to enjoin the commissioner from taking, and the corporation from delivering, the assets, on the ground that the repealing act was unconstitutional. The hearing was upon the application for a temporary injunction until the final hearing.]

The defendant corporation is a stock corporation authorized to issue life policies upon the mutual plan of insurance, but it is not strictly a mutual insurance company, and the policy-holders are not necessarily members of the corporation, and have no right to participate in its management. The complainants appear before the court only as creditors of the company. Being citizens of the state of New York, they have a right to bring this bill against the defendants, citizens of Connecticut, and their interest as creditors of the corporation and *cestuis que trust* of the fund, which is now in the control of the directors of the corporation, entitles them to maintain their suit if they have suffered injury. The principle that a stockholder of a company can not maintain a bill in equity against a wrong-doer to prevent an injury

to the corporation, unless it shall be averred, and shall affirmatively appear, that the corporation has refused to take measures to protect itself, does not extend to a bill which is in good faith filed by a creditor.

*Note.* Creditor may sue for wrongs done to the corporation: 1896, *In re Brockway Mfg. Co.*, 89 Me. 121, 56 Am. St. Rep. 401; 1897, *Wilcox Cordage Co. v. Mosher*, 114 Mich. 64 (statute); 1898, *Winchester v. Mabury*, 122 Cal. 522, 55 Pac. Rep. 393 (statute); 1898, *Gores v. Day*, 99 Wis. 276 (statute); 1899, *Seeberger v. McCormick*, 178 Ill. 404; 1899, *Hodges' Adm'x v. South Fork L. Co.*, 21 Ky. L. Rep. 20, 50 S. W. Rep. 969; 1899, *Hequembourg v. Edwards*, 155 Mo. 514, 50 S. W. Rep. 908; 1900, *Cunningham v. Wechselberg*, 105 Wis. 339, 81 N. W. Rep. 414 (no statute necessary); 1900, *Killen v. State Bank*, 106 Wis. 546, 82 N. W. Rep. 536.

**Sec. 659. 6. To set aside fraudulent corporate conveyance.**

**EMERY COLE, RESPONDENT, v. THE MILLERTON IRON COMPANY  
ET AL., RESPONDENTS ET AL., APPELLANTS.<sup>1</sup>**

1892. IN THE COURT OF APPEALS OF NEW YORK. 133 N. Y.  
Rep. 164-169, 28 Am. St. Rep. 615.

[This action was brought by plaintiff, a judgment creditor of the National Mining Company of Pawling, to set aside a conveyance made by it of all its property to defendant, the Millerton Iron Company, and also to release said property from the lien of a mortgage executed by that company to defendant, the Mercantile Trust Company, and for appointment of a receiver, etc.]

FINCH, J. The plaintiff is a creditor of the National Mining Company, a corporation formed and existing under the laws of this state. He commenced an action to recover damages done to his property by the wrongful act of the corporation, serving the summons in October, 1887, and recovering judgment in July of the next year. During the pendency of the action all the property and assets of the debtor corporation were transferred to the Millerton Iron Company, also a domestic corporation, upon a nominal consideration, except an assumption by the vendee of the debts of the vendor, and thereupon the former executed a mortgage to the Mercantile Trust Company covering all its property, including that acquired from the National Mining Company. When the plaintiff obtained his judgment nothing remained upon which it was a lien and his execution was returned unsatisfied. He then began this action, in which he assailed the transfers made with a view of subjecting the property of the debtor corporation to the satisfaction of his debt. Upon the trial his complaint was dismissed, but the general term reversed the judgment and ordered a new trial. From that order the trust company alone appeals and has given the usual stipulation for judgment absolute.

The trial court has refused to find that the National Company was

<sup>1</sup> Statement abridged and arguments omitted.

insolvent at the date of its transfer, but did find that such transfer suspended and terminated the regular business of the grantor, and was made and accepted with that purpose and intention. The practical effect was to dissolve the grantor corporation and subject its charter to forfeiture at the hands of the state, for it voluntarily stripped itself of all its property and assets and became incapable, and intended to be and remain incapable, of performing its corporate duties. Such a transfer, which involves the destruction of the corporation and an abandonment of the purposes of its organization, is illegal as against creditors, whose rights are thereby sacrificed and their remedies destroyed. The transfer was illegal, also, because made in contemplation of insolvency. Those who accomplished it knew that its necessary and inevitable effect would be to make the corporation unable to pay its debts, and must be held to have intended that consequence of their acts. I do not agree to that reading of the statute which limits its prohibition to cases in which payment of some note or obligation has been previously refused. An interpretation so narrow would seriously maim and distort the obvious purpose of the statute and make a transfer, in contemplation of insolvency, good the day before a note matured and bad the day after. As against the creditor the transfer to the Millerton Company was illegal and in fraud of its rights. The assets of a corporation are a trust fund for the payment of its debts upon which the creditors have an equitable lien, both as against the stockholders and all transferees, except those purchasing in good faith and for value. (*Bartlett v. Drew*, 57 N. Y. 587; *Brum v. Ins. Co.*, 16 Fed. Rep. 140; *Morawetz on Corporations*, 791.) The Millerton Company was not such a purchaser. It parted with nothing. It knew and participated in the illegal purpose to destroy the National Company, to make it utterly insolvent, and to deprive its creditors of the trust fund upon which they had a right to rely, and so they were at liberty to set aside the transfer so far as it barred their remedy and to enforce their equitable lien upon the property in the hands of the transferee.

It is not a sufficient answer to say that the transfer was rather formal than real, because, before its occurrence, the Millerton Company, having the same stockholders and officers, managed and conducted the business of the National Company before the transfer as well as after, and that what occurred was a practical consolidation. Companies may consolidate, but under the permission and safeguards of the statute, all of which were disregarded, and what is called the formal transaction cuts off and destroys the right of the creditor, and is being used for that exact purpose.

Neither is it an answer to say that the creditor is not harmed by a change of the party liable to pay, unless there be some disproportion in the assets. He can not be forced to change his debtor against his will, and it appears in the proof that the transfer to the Millerton Company was followed by a mortgage sweeping in to its lien and peril the very property transferred.

We are satisfied, therefore, that the plaintiff was entitled to judg-

ment of sequestration and for a receiver, and so the order of the general term was right. The judgment obtained by Chapman is not a bar to the remedy. It is not relied upon for that purpose, and the appointment of a receiver was without notice to the attorney-general, as the law required. (Laws of 1883, ch. 378.) In the present case the plaintiff must give such notice when he applies for the appointment.

The rights of the mortgagee, who is the present appellant, need not now be accurately determined. Whether that mortgage was valid at all for want of proper consents, or whether any of the bondholders have acquired equities superior to those of the plaintiff, may or may not become questions in the future. Enough appears to show that some of them do not stand in the attitude of *bona fide* creditors, and that the remedies of all may be confined to the property of the Miller-ton Company not derived from the National, until at least the former is exhausted. Those questions, however, may be left to the developments consequent upon further proceedings.

The order of the general term should be affirmed and judgment absolute for the plaintiff be rendered upon the stipulation, with costs. All concur.

Order affirmed and judgment accordingly.

*Note.* See, 1874, Bartlett v. Drew, 57 N. Y. 587; 1899, U. S. Rubber Co. v. Am. O. L. Co., 96 Fed. Rep. 891; 1899, Slack v. N. W. Nat'l Bank, 103 Wis. 57, 79 N. W. Rep. 51.

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Sec. 660. 7. Conditions precedent to creditors' rights to maintain suit in equity.

#### HOLLINS v. BRIERFIELD COAL AND IRON COMPANY.<sup>1</sup>

1893. IN THE SUPREME COURT OF THE UNITED STATES. 150 U. S. 371, 14 Sup. Ct. 127.

[Appeal from the circuit court of the United States for the middle district of Alabama.]

The iron company was incorporated May 4, 1882. On September 1, 1882, a conveyance was made by the company to P. B. Plumb, as trustee, to secure an issue of \$500,000 in bonds. On July 25, 1887, Plumb requested a further conveyance and assurance, pursuant to a covenant in the deed of September, 1882, which further conveyance was executed by the company on July 29, 1887. On August 1 he demanded the surrender of all the company's property to him as trustee. This was done, and he placed John G. Murray in charge, to control and manage it. On August 3 he filed a bill in the circuit court of the United States against the company, certain stockholders, bondholders and creditors, though not the plaintiffs in the present

<sup>1</sup> Statement abridged; arguments and part of opinion omitted.

suit. That bill set out the stockholders, with the amounts subscribed and paid, and alleged the subscribers were liable for the unpaid subscriptions, but that the assistance of the court was necessary for the assessment of such sums. It also set out the issue of the bonds, and their owners, default in the payment of the interest, the property and indebtedness of the company—the unsecured indebtedness being about \$200,000. The bill asked that all the creditors of the corporation be permitted to make themselves parties and have their claims adjudicated; that a full administration be had, and, if need be, a foreclosure and sale. Proceedings resulted, on July 8, 1889, in a decree for the foreclosure and a sale of the property. On October 28, 1887, these appellants, as plaintiffs, filed a bill in the same court, making the iron company and sundry stock and bond holders, with Plumb, defendants. Plaintiffs were unsecured creditors, having claims contracted four or five years after the issue of the bonds and execution of the trust deed, and sued on behalf of themselves and all other creditors who were willing to come in and contribute to the expenses of the suit. After setting forth their claims, they alleged that the conveyance to Plumb was absolutely void; that a large amount was still due on the stock. They asked to have a receiver appointed and the property sold in satisfaction of their claims, and that such receiver have authority to collect the unpaid stock subscriptions, to be also applied in satisfaction of their claims. They alleged the pendency of the suit brought by Plumb, but did not ask to intervene therein. After the decree of foreclosure and sale in the Plumb case a final decree was entered, dismissing the bill, and plaintiffs appealed.]

MR. JUSTICE BREWER. The plaintiffs were simple contract creditors of the company. Their claims had not been reduced to judgment, and they had no express lien by mortgage, trust deed or otherwise. It is the settled law of this court that such creditors can not come into a court of equity to obtain the seizure of the property of their debtor, and its application to the satisfaction of their claims, and this notwithstanding a statute of the state may authorize such a proceeding in the courts of the state. The line of demarcation between equitable and legal remedies in the federal courts can not be obliterated by state legislation. *Scott v. Neely*, 140 U. S. 106, 11 Sup. Ct. 712; *Cates v. Allen*, 149 U. S. 451, 13 Sup. Ct. 883, 977. Nor is it otherwise in case the debtor is a corporation, and an unpaid stock subscription is sought to be reached. *Tube-Works Co. v. Ballou*, 146 U. S. 517, 13 Sup. Ct. 165; *Cattle Co. v. Frank*, 148 U. S. 603, 612, 13 Sup. Ct. 691. Nor is this rule changed by the fact that the suit is brought in a court in which at the time is pending another suit for the foreclosure of a mortgage or trust deed upon the property of the debtor. Doubtless, in such foreclosure suit, the simple contract creditor can intervene, and if he has any equities in respect to the property, whether prior or subsequent to those of the plaintiff, can secure their determination and protection; and here, by the express language of the bill filed by the trustee, all claimants and creditors were invited to present their claims and have them adjudicated.



These plaintiffs did not intervene, though, as shown by the allegations of their bill, they knew of the existence of the foreclosure suit. Neither did they apply for a consolidation of the two suits. On the contrary, the whole drift and scope of their suit was adverse to that brought by the trustee, and in antagonism to the rights claimed by him. They obviously intended to keep away from that suit, and maintain, if possible, an independent proceeding to have the property of the debtor applied to the satisfaction of their claims. But this, as has been decided in the cases cited, can not be done. The excuse suggested, that the rule which forbids in a suit to foreclose a mortgage the litigation of a title adverse to that of the mortgagor prevented them from intervening, is not sound. Their rights, like those of the trustee and the bondholders, were derived from the corporation defendant. Each claimed under it, and the validity and amount of such claims were matters properly and ordinarily considered and determined in a foreclosure suit. It is true the corporation might admit the validity of any or all of the claims, and then the validity could only be a subject of inquiry as between the claimants for the purpose of determining the matter of priority; but to that extent, at least, both validity and amount are always open to contest and determination.

It is urged, however, that this court has sustained the validity of proceedings and decrees in suits of this nature, in which it appeared that the plaintiffs had not exhausted their remedies at law, and the cases of *Sage v. Railroad Co.*, 125 U. S. 361, 8 Sup. Ct. 887, and *Mellen v. Iron Works*, 131 U. S. 352, 9 Sup. Ct. 781, are cited as illustrations. But, passing by other matters disclosed by the facts of those cases, it will be noticed that in neither of them was the objection made at the outset, and when action on the part of the court was invoked. Defenses existing in equity suits may be waived, just as they may in law actions, and, when waived, the cases stand as though the objection never existed. Given a suit in which there is jurisdiction of the parties, in a matter within the general scope of the jurisdiction of courts of equity, and a decree rendered will be binding, although it may be apparent that defenses existed, which, if presented, would have resulted in a decree of dismissal. \* \* \*

This doctrine has been recognized, not merely in the cases cited, but also in those of *Reynes v. Dumont*, 130 U. S. 354, 9 Sup. Ct. 486; *Kilbourn v. Sunderland*, 130 U. S. 505, 9 Sup. Ct. 594; *Brown v. Iron Co.*, 134 U. S. 530, 10 Sup. Ct. 604. None of these cases question the proposition that, if the objection is seasonably presented, it will be effective.

But it is earnestly insisted that it has been held by this court in *Case v. Beauregard*, 101 U. S. 688, that whenever a creditor has a trust in his favor, or a lien upon property for a debt due him, he may go into equity without exhausting his legal remedies; that it has also frequently been affirmed that the capital stock and assets of a corporation constitute a trust fund for the benefit of its creditors, which neither the officers nor stockholders can divert or waste; and several cases are cited,—among them, that of *Sanger v. Upton*, 91 U. S.

56,—in which, perhaps, the proposition is asserted in the most emphatic and direct language, and *Terry v. Anderson*, 95 U. S. 628, 636, in which Chief Justice Waite made these observations: “Ordinarily, a creditor must put his demand into judgment against his debtor, and exhaust his remedies at law, before he can proceed in equity to subject choses in action to its payment. To this rule, however, there are some exceptions; and we are not prepared to say that a creditor of a dissolved corporation may not, under certain circumstances, claim to be exempted from its operation. If he can, however, it is upon the ground that the assets of the corporation constitute a trust fund, which will be administered by a court of equity, in the absence of a trustee; the principle being that equity will not permit a trust to fail for want of a trustee.”

While it is true language has been frequently used to the effect that the assets of a corporation are a trust fund held by a corporation for the benefit of creditors, this has not been to convey the idea that there is a direct and express trust attached to the property. As said in 2 Pom. Eq. Jur., § 1046, they “are not, in any true and complete sense, trusts, and can only be called so by way of analogy or metaphor.”

To the same effect are decisions of this court. The case of *Graham v. Railroad Co.*, 102 U. S. 148,<sup>1</sup> was an action by a subsequent creditor to subject certain property, alleged to have been wrongfully conveyed by the corporation debtor, to the satisfaction of his judgment; and the very proposition here presented was then considered, and, in respect to it, the court, by Mr. Justice Bradley, said (page 160): \* \* \*

“When a corporation becomes insolvent, it is so far civilly dead that its property may be administered as a trust fund for the benefit of its stockholders and creditors. A court of equity, at the instance of the proper parties, will then make those funds trust funds which, in other circumstances, are as much the absolute property of the corporation as any man’s property is his.”

With reference to the suggestion in this paragraph, it may be observed that the court does not attempt to determine who are proper parties to maintain a suit for the administration of the assets of an insolvent corporation. All that it decides is that, when a court of equity does take into its possession the assets of an insolvent corporation, it will administer them, on the theory that they, in equity, belong to the creditors and stockholders, rather than to the corporation itself. In other words,—and that is the idea which underlies all these expressions in reference to “trust” in connection with the property of a corporation,—the corporation is an entity, distinct from its stockholders as from its creditors. Solvent, it holds its property as any individual holds his, free from the touch of a creditor who has acquired no lien; free, also, from the touch of a stockholder who, though equitably interested in, has no legal right to, the property. Becoming insolvent, the equitable interest of the stockholders in the property, together with their conditional liability to the creditors, places the property in a condition of trust, first for the creditors, and then for the stockholders. Whatever

<sup>1</sup> *Supra*, p. 1809.

of trust there is arises from the peculiar and diverse equitable rights of the stockholders as against the corporation in its property, and their conditional liability to its creditors. It is rather a trust in the administration of the assets after possession by a court of equity, than a trust attaching to the property, as such, for the direct benefit of either creditor or stockholder.

Again, in the case of *Railway Co. v. Ham*, 114 U. S. 587, 5 Sup. Ct. 1081, it appeared that four railway corporations, owing debts, were consolidated under authority of law, and by the terms of the consolidation agreement the new corporation was to protect the debts of the old. Subsequently, the new corporation executed a mortgage on all its property, and, in a contest between the mortgagees and the unsecured creditors of one of the constituent companies, the court held that the lien of the mortgagees was prior. In respect to this, Mr. Justice Gray (page 594, 114 U. S., and page 1084, 5 Sup. Ct.) thus stated the law: "It was contended that the property of the Toledo and Wabash Railway Company was a trust fund for all its creditors, and that upon the consolidation the Toledo, Wabash and Western Railway Company took the property of the Toledo and Wabash Railway Company charged with the payment of all its debts. The property of a corporation is doubtless a trust fund for the payment of its debts, in the sense that when the corporation is lawfully dissolved, and all its business wound up, or when it is insolvent, all its creditors are entitled, in equity, to have their debts paid out of the corporate property before any distribution thereof among the stockholders. It is also true, in the case of a corporation, as in that of a natural person, that any conveyance of property of the debtor, without authority of law, and in fraud of existing creditors, is void as against them."

The case of *Fogg v. Blair*, 133 U. S. 534, 541, 10 Sup. Ct. 338, presented a similar question; and this court, by Mr. Justice Field, observed: "We do not question the general doctrine invoked by the appellant, that the property of a railroad company is a trust fund for the payment of its debts, but do not perceive any place for its application here. That doctrine only means that the property must first be appropriated to the payment of the debts of the company before any portion of it can be distributed to the stockholders. It does not mean that the property is so affected by the indebtedness of the company that it can not be sold, transferred, or mortgaged to *bona fide* purchasers for a valuable consideration, except subject to the liability of being appropriated to pay that indebtedness. Such a doctrine has no existence."

In the case of *Hawkins v. Glenn*, 131 U. S. 319, 332, 9 Sup. Ct. 739, which was an action brought by the trustee of a corporation against certain of its stockholders to recover unpaid subscriptions, and in which the defense of the statute of limitations was pleaded, Chief Justice Fuller referred to this matter in these words: "Unpaid subscriptions are assets, but have frequently been treated by courts of equity as if impressed with a trust *sub modo*, upon the view that, the corporation being insolvent, the existence of creditors subjects these

liabilities to the rules applicable to funds to be accounted for as held in trust, and that, therefore, statutes of limitation do not commence to run, in respect to them, until the retention of the money has become adverse, by a refusal to pay upon due requisition."

These cases negative the idea of any direct trust or lien attaching to the property of a corporation in favor of its creditors, and at the same time are entirely consistent with those cases in which the assets of a corporation are spoken of as a "trust fund," using the term in the sense that we have said it was used.

The same idea of equitable lien and trust exists, to some extent, in the case of partnership property. Whenever, a partnership becoming insolvent, a court of equity takes possession of its property, it recognizes the fact that in equity the partnership creditors have a right to payment out of those funds in preference to individual creditors, as well as superior to any claims of the partners themselves; and the partnership property is therefore sometimes said, not inaptly, to be held in trust for the partnership creditors, or that they have an equitable lien on such property, yet, all that is meant by such expressions is the existence of an equitable right, which will be enforced whenever a court of equity, at the instance of a proper party, and in a proper proceeding, has taken possession of the assets. It is never understood that there is a specific lien or a direct trust.

A party may deal with a corporation, in respect to its property, in the same manner as with an individual owner, and with no greater danger of being held to have received into his possession property burdened with a trust or lien. The officers of a corporation act in a fiduciary capacity in respect to its property in their hands, and may be called to an account for fraud, or sometimes even mere mismanagement, in respect thereto; but, as between itself and its creditors, the corporation is simply a debtor, and does not hold its property in trust, or subject to a lien in their favor, in any other sense than does an individual debtor. This is certainly the general rule, and, if there be any exceptions thereto, they are not presented by any of the facts in this case. *Neither the insolvency of the corporation, nor the execution of an illegal trust deed, nor the failure to collect in full all stock subscriptions, nor all together, gave to these simple contract creditors any lien upon the property of the corporation, nor charged any direct trust thereon.*

With respect to the propriety of the decree of dismissal in this suit after the entry of the decree of foreclosure in the trustee suit, the case of *Stout v. Lye*, 103 U. S. 66, is conclusive. Indeed, that case is conclusive of every question in this, except such as arise from the fact that the debtor is a corporation, rather than an individual. It appeared that, pending a foreclosure suit, J. W. and J. O. Stout obtained a judgment against the mortgagor on an unsecured claim. They thereupon instituted a suit, making both mortgagee and mortgagor parties defendant, to set aside the mortgage as illegal, or, if not illegal, to have its amount reduced by certain payments of usuri-

ous interest. While this suit was pending the foreclosure suit passed into decree, the Stouts having never been made parties or entered an appearance in that suit. Thereupon, their suit was dismissed, and such dismissal was held by this court proper, on the ground that the Stouts, being simple contract creditors at the time the foreclosure suit was commenced, were not only unnecessary but improper parties. "If they had been made parties when the suit was begun, they could have done nothing by way of defense to the action until they had acquired some specific interest in the mortgaged property. As creditors at large, they were powerless in respect to the foreclosure proceedings; but, when they obtained their judgment,—not before,—they were in a position to contest in all legitimate ways the validity and extent of the superior lien which the bank asserted on the property, in which, by the judgment, they had acquired a specific interest." And on the further ground that the mortgagor represented in the foreclosure suit not merely himself, but all parties who, like the Stouts, acquired any interest in the property since the commencement of that suit.

So, here, these plaintiffs were simple contract creditors when the trustee's suit was commenced. That suit passed to decree of foreclosure, and up to that time these plaintiffs had acquired no specific lien upon the property. They entered no appearance in that suit, did not intervene, or claim any rights in the property, and they were represented in that suit by the corporation, the party under whom both they and the trustee claimed. *A decree of dismissal was therefore proper. It appears in the record as a decree upon the merits. It should have been for want of jurisdiction, and to that extent the decree, as entered, will be modified.* The appellants will be charged with all the costs in the case.

Dismissed for want of jurisdiction.

Mr. Justice Brown and Mr. Justice Jackson dissented.

### SUBDIVISION III. THE CREDITORS AND CORPORATE OFFICERS.

#### ARTICLE I. RIGHTS OF CREDITORS.

#### Sec. 661. A. Common law liability of officers.

##### 1. Directors' responsibility.

#### NIX v. MILLER.<sup>1</sup>

1899. IN THE SUPREME COURT OF COLORADO. 26 Col. 203, 57  
Pac. Rep. 1084-1087.

CAMPBELL, C. J. This action by a judgment creditor of an insolvent corporation, whose right of execution on the judgment was returned *nulla bona*, was brought against its directors to recover from

<sup>1</sup> Part of opinion and opinion on rehearing omitted.



them the amount of the judgment, on the ground of their wrongful diversion and misapplication of the corporate assets. The judgment below went against two of the directors, one of whom (Charles H. Nix) has appealed. \* \* \*

The propositions vigorously maintained by appellant may thus be stated: First, that appellant did not participate in or consent to the alleged frauds of the directors that worked the insolvency of the corporation; second, that if, in law, by inattention to his official duty he may be held to have contributed to the alleged fraudulent acts, they are not of such a character as to entail personal liabilities upon the director committing them; third, that the alleged frauds were committed before the plaintiff became a creditor of the corporation, and, therefore, even if the appellant participated therein, the plaintiff, as a subsequent creditor, can not call him to account therefor; fourth, that before the plaintiff became a creditor, appellant resigned his office as director, and so can not be chargeable for any default of the other directors respecting plaintiff's charge of fraud, in so far as it was committed after the time of his resignation; fifth, that he is not liable as a stockholder.

Preliminary to the separate consideration of these propositions, it is well briefly to state the salient facts necessary to an understanding of the case: Previous to July, 1892, the firm of Home & Co., composed of W. S. Home and Charles H. Nix, was engaged in the general merchandise business at the town of Ouray. Being indebted, they conceived the plan of forming a corporation to which to transfer all of the firm property, with a view the better to pay off this indebtedness. In accordance therewith, the Ouray Mercantile Company was formed by the members of this firm, they, and two others named by them, becoming the directors, the capital stock consisting of \$20,000, which was issued as fully paid up stock, the consideration being the transfer by the firm to it of the firm property, burdened by the indebtedness of the firm, which the corporation assumed and agreed to pay. Its business was carried on and purchases made from time to time for a period of eight months, when the corporation, about March 26, 1893, became insolvent and ceased doing business. The plaintiff sold merchandise to it between the latter part of December, 1892, and the date of insolvency. A judgment against the corporation for the amount of his debt was recovered, and, the execution thereon being returned unsatisfied, the plaintiff brought this action against the directors, charging them with diversion of the corporate property. The court found, as a matter of fact, that the directors had misapplied over \$11,000 of the corporate assets, which caused its insolvency, and this insolvency was admitted at the trial.

1. It may be that the record failed to show any direct, positive and specific fraudulent act of the appellant concerning the corporate business. He himself testifies that, practically, he gave it no personal attention, but entrusted it entirely to Home and Sparks, his co-directors. That they were guilty of misappropriation of the corporate assets, as the trial court found, the appellant, in discussing this branch of the case, does



not controvert, but his defense is that he had nothing whatever to do with such acts, and did not participate therein or consent thereto. It is not every act of a director of a mercantile corporation, whether it be of omission or commission, that entails upon him individual liability for loss to a stockholder or creditor resulting from such act. While the appellant in this case may not be held for knowingly committing a fraudulent act, yet for gross neglect of and inattention to his official duty he may be, and under the facts of this case is, accountable to the plaintiff, as a judgment creditor, just as certainly as if he personally did the act that caused the damage. That his neglect of duty in this direction permitted his co-directors to commit the acts that worked the injury to plaintiff we think entirely clear, and the proof is amply sufficient to uphold the findings of the trial court to that effect.

2. The second point is closely allied with the first, and might well be considered with it. The acts of the directors complained of were nothing more nor less than a diversion of the funds of the corporation from their legitimate channel, and, instead of paying therewith corporate debts, applying them to the payment of the individual debts of one of the directors. We have already decided that appellant's gross neglect of the company affairs enabled the active managing directors of the company to accomplish this fraud. That this misapplication of the corporate property, which is a trust fund for the creditors, instead of paying therewith the corporate indebtedness,—when the necessary result is to make the corporation insolvent, thus rendering creditors unable to collect from it their claims,—is a fraud upon them, for which they may proceed against the directors after fruitlessly exhausting their remedy against the corporation, is too clear for dispute. *Tayl. Priv. Corp.* (3d ed.), §§ 616–619, 756–758, *et seq.*; 3 *Thomp. Corp.*, § 4152, and cases cited; 1 *Beach Priv. Corp.*, § 257c, *et seq.*; *Cole v. Iron Co.*, 133 N. Y. 164, 30 N. E. Rep. 847; *Scott v. Depeyster*, 1 Edw. Ch. 512. Appellant relies upon *Briggs v. Spaulding*, 141 U. S. 132, 11 Sup. Ct. 924, as authority for his position that the acts of the directors here are not actionable. The theory of the bill in that case was that the defendants were “liable, not to stockholders nor to creditors, as such, but to the bank, for losses alleged to have occurred during their period of office because of their inattention.” The defendants were held not liable, but the charges against them were not of the grave and serious character established against these defendants. In the opinion, Chief Justice Fuller thus speaks: “If particular stockholders or creditors have a cause of action against the defendant individually, it is not sought to be proceeded on here, and the disposition of the questions arising thereon would depend upon different considerations.” The rule he lays down in that case, governing the liability of directors to the corporation, would, however, clearly make these defendants liable, under the facts of this case, while confessedly the duty of directors to creditors is to be determined by a stricter rule.

3. It is held by the highest authority in this country (*Graham v.*

Railroad Co., 102 U. S. 148) that the disposal by a corporation of any of its property can not be questioned by any of its subsequent creditors. Other authorities might be cited, but this case is controlling. It is upon the ground that the diversion of funds occurred before the plaintiff became a creditor that appellant seeks to escape liability. If the facts of the case at bar brought it within the principle of the authority cited, we would not hesitate to recognize the rule therein announced, because not only is it a sound one, but, in the absence of a controlling rule in our own jurisdiction (of which there is none), we would be inclined to follow the decision of the august tribunal from which it emanated.

Whether, as contended by appellee, the character of the action in this case is different in kind from the principal case, or whether it is, as claimed by him, one merely to compel an accounting of a trust fund, is not important; for conceding that the two are of the same class, there is enough in the facts of the pending action, as set out in the findings of facts, which the record supports, to differentiate this case from that, in this: that the fraudulent acts here complained of were clearly intended to operate as a fraud upon subsequent creditors, and of necessity, as the directors must have known, could have no other effect. So that this case falls within the exception of the general rule that subsequent creditors may not question a fraudulent disposition of their debtor's property made before the relation of creditor and debtor existed, and is brought within that class of cases which hold, where such fraudulent disposition of the debtor's property was intended as a fraud upon subsequent creditors, and necessarily could have no other effect, that the latter may complain. It is also to be observed that it does not appear just what proportion of the fund was misapplied before, and what after, the plaintiff became a creditor. Upon the showing made by plaintiff, it was incumbent upon the defendants to make this point clear.

4. If the appellant resigned as a director before the plaintiff became a creditor, it does not necessarily follow that this releases him from all previous acts of misfeasance. If, as we have held, the diversion of assets was intended as a fraud upon subsequent creditors, and so resulted, and appellant by his inattention to duty contributed thereto so as to make him personally holden, the same as those directly guilty of the fraud, his liability may have become fixed for past acts before his resignation took effect, so that, in one sense, and as to past acts, it is immaterial as to the exact date of his resignation. But the finding of the trial court, to the effect that this resignation was not effectuated until after the plaintiff became a creditor and the wrong was committed, is not without support in the record. At the trial the appellant produced a written instrument, addressed to the company, and signed by him, tendering his resignation, and it bore date November 26, 1892, and this was before the plaintiff became a creditor. We may safely concede that the appellant had a right to resign, and that there was no necessity for an acceptance of his resignation by the board of directors, formal or otherwise. That his connection as a

director with the corporation, and his liability for all subsequent acts, ceased the moment he tendered his resignation to the proper authority, even if that authority refused to accept it, is doubtless true. It may also be conceded that the legal presumption is that a written instrument like this was executed when it bore date, and that it was delivered at the same time. 2 Whart. Ev. (3d ed.), § 1313; 1 Greenl. Ev. (15th ed.), § 38; *Holbrook v. Zinc Co.*, 57 N. Y. 616; *People v. Snyder*, 41 N. Y. 397; *Abb. Tr. Ev.*, p. 527, § 10. Still there is enough in the record to justify the finding that the resignation was not tendered or made until March 18, 1893, when it was formally accepted by the board. Among other things bearing upon this point is the fact that Mr. Nix, when on the stand, did not state when he tendered his resignation, or that it was in fact made prior to the date of acceptance, and his subsequent conduct in relation to the corporation was of such a character as to indicate that he still considered himself as a director, and acted in that capacity. \* \* \*

(Fifth point omitted.)

Affirmed.

*Note.* See, generally, note 49 Am. St. Rep. 698, and 1832, *Robinson v. Smith*, 3 Paige (N. Y.) 222, 24 Am. Dec. 212; 1850, *Hodges v. N. E. Screw Co.*, 1 R. I. 312, 53 Am. Dec. 624; 1868, *Bank v. Hill*, 56 Maine 385, 96 Am. Dec. 470; 1878, *In re Wincham, etc., Co.*, 9 Ch. D. 329; 1887, *Delano v. Gardner Case*, 121 Ill. 247; 1888, *Seale v. Baker*, 70 Texas 283, 8 Am. St. Rep. 592; 1889, *Marshall v. Farmers', etc., Bank*, 85 Va. 676, 17 Am. St. Rep. 84, note 95, *infra*, p. 1879; 1895, *Grant v. Walsh*, 145 N. Y. 592, 45 Am. St. Rep. 626; 1895, *Tradesman Pub. Co. v. Knoxville, etc., Co.*, 95 Tenn. 634, 49 Am. St. Rep. 943; 1896, *Tate v. Bates*, 118 N. C. 287, 54 Am. St. Rep. 719; 1896, *In re Brockway Mfg. Co.*, 89 Maine 121, 56 Am. St. Rep. 401; 1898, *Corn Exchange Bk. v. Solicitors, etc.*, 188 Pa. St. 330, 68 Am. St. Rep. 872; 1898, *Bird v. Magowan*, — N. J. Eq. —, 43 Atl. Rep. 278; 1898, *Warner v. Pennoyer*, 91 Fed. 587, 44 L. R. A. 761; 1899, *Seeberger v. McCormick*, 178 Ill. 404; 1899, *Kent v. Clark*, 181 Ill. 237; 1899, *Hequembourg v. Edwards*, — Mo. —, 50 S. W. Rep. 908; 1899, *In re Natl. Bank*, 68 L. J. Ch. 634, 81 L. T. (N. S.) 363; 1899, *Warren v. Robinson*, 19 Utah 289, 75 Am. St. Rep. 734; 1900, *Hayward v. Leeson*, 176 Miss. 310, 49 L. R. A. 725; 1900, *Michelson v. Pierce*, 107 Wis. 85, 82 N. W. Rep. 707; 1901, *Bosworth v. Allen*, 168 N. Y. 157, 61 N. E. 163, 55 L. R. A. 751, note, 85 Am. St. R. 667; 1901, *Campbell v. Watson*, — N. J. Eq. —, 50 Atl. 120; 1902, *Scott v. Farmers' & M. Bk.*, — Tex Civ. App. —, 66 S. W. 485; 1902, *Winchester v. Howard*, 136 Cal. 432, 89 Am. St. R. 153, 69 Pac. 77.

Compare, 1900, *Utley v. Hill*, 155 Mo. 232, 78 Am. St. Rep. 569.

After insolvency the directors are trustees of the corporate assets for the benefit of creditors and shareholders. See, generally, 1887, *Sweeney v. Grape Sugar Co.*, 30 W. Va. 443, 8 Am. St. Rep. 88; 1889, *Beach v. Miller*, 130 Ill. 162, 17 Am. St. Rep. 291, note 301; 1895, *Tradesman Pub. Co. v. Knoxville*, 95 Tenn. 634, 49 Am. St. Rep. 943; 1896, *In re Brockway Mfg. Co.*, 89 Maine 121, 56 Am. St. Rep. 401; 1899, *Millsaps v. Chapman*, 76 Miss. 942, 71 Am. St. Rep. 547. Compare 1900, *Wilson v. Stevens*, 129 Ala. 630, 87 Am. St. R. 86.

*Contra*, 1900, *Utley v. Hill*, 155 Mo. 232, 78 Am. St. Rep. 569.

By the weight of authority, however, creditors may be preferred, even after insolvency, until the property has been taken possession of by a court of equity or a trustee to wind up its concerns. See, *supra*, §§ 645, 646.

Sec. 662. Same.

MARSHALL v. F. & M. SAVINGS BANK OF ALEXANDRIA ET AL.<sup>1</sup>

1889. IN THE SUPREME COURT OF APPEALS OF VIRGINIA. 85 Va. Rep. 676-689, 17 Am. St. Rep. 84.

[Appeal from decree of lower court dismissing a bill by Marshall, on behalf of himself and the other creditors of the bank, to distribute its assets and to charge the officers and directors with losses alleged to be due to their negligence and inattention. The matter was referred to a commissioner who reported that the directors not only did not exercise ordinary care, but were guilty of gross negligence. Upon the hearing in the lower court this part of the report was overruled and plaintiff appealed.]

LACY, J. \* \* \* By the appellees no error is assigned, so the question involved here does not raise any other question than the single inquiry, was there such negligence on the part of the directors of this bank as to make them, or any of them, personally liable for its losses? There is no dispute as to what the losses have been, and their several amounts; and of the terms or periods as to which each director is liable, if at all. The appellees insist, through their learned counsel, that while there have been errors of judgment and unfortunate loans made, there has been no negligence. The liability of directors for losses growing out of their mismanagement of the concerns of the bank, and their negligence in the discharge of their duties, has been often the subject of judicial investigation and decision. It is a question at this day well understood by the profession, and is not controverted to any degree by the learned counsel in this case. We find the settled rule upon this subject well stated in a recent work of great practical usefulness.

The American and English Encyclopedia of Law, under the head "Banks," speaking of directors, says: "The directors of a bank have the general control and government of its affairs, and constitute the corporation. They are bound to exercise ordinary skill and diligence, and are liable for losses resulting from mismanagement of the affairs and business of the bank." Citing *Society v. Underwood*, 9 Bush 609, which appears to have been criticised in *Zinn v. Mendel*, 9 W. Va. 580-597, and by Mr. Redfield in 13 Amer. Law Reg. (N. S.) 218; *Dunn v. Kyle*, 14 Bush 134; *Brinckerhoff v. Bostwick*, 88 N. Y. 52; *Chester v. Halliard*, 34 N. J. Eq. 341; *Spering's Appeal*, 71 Pa. St. 11. There it is further said: "But for excusable mistakes concerning the law, and for errors of judgment when acting in good faith, they are not liable." Citing *Spering's Appeal*, *supra*; *Dunn v. Kyle*, *supra*; *Godbold v. Bank*, 11 Ala. 191; *Hodges v. Screw Co.*, 1 R. I. 312. See 2 Amer. & Eng. Cyclop. Law, 114, 116. Morse, in his work on Banks and Banking, says: "If bank

<sup>1</sup> Statement abridged and part of opinion omitted.

directors do not manage the affairs and business of the bank according to the directions of the charter, and in good faith, they will be liable to make good all losses which their misconduct may inflict upon either stockholders or creditors, or both. *Hodges v. Screw Co.*, *supra*. They may be held to account to an injured party in a court of chancery (*Bank v. St. Johns*, 25 Ala. 566), or they, or any one of their number who shared in the wrong-doing, may be sued at law for damages. *Conant v. Bank*, 1 Ohio St. 298. \* \* \* They are required simply to show a reasonable capacity for the position they accept; to use in it their best discretion and industry; to show the scrupulous *bona fides* and conscientiousness in every matter, however minute, which is exacted rigorously from all trustees of the property of others; and to obey accurately the requisitions of the charter, or of the general law under which they are organized." *Morse, Banks*, 133.

Mistakes as to what is the law serve to excuse cases where correct knowledge could be reasonably expected only from a professional man, and even in such cases, if the directors feel any doubts, they may be guilty of neglect, if they fail to seek and be guided by competent legal advice. But ignorance of any fact in the bank's affairs, which it is their duty to know, can never be set up by them in defense or exculpation for any act which the existence of that fact should have prohibited. *Morse, Banks*, 135. The high degree of confidence and responsibility resting upon directors of corporations has often led the courts to regard them as trustees, and to declare the relationship existing between them and the stockholders to be that of trustees and *cestui que trust*, respectively. If this can be asserted with regard to the generality of corporations, it is peculiarly and exceptionally true with regard to banking corporations. The directors of a bank are not trustees for the stockholders alone, but they owe an even earlier duty to the depositors. The law is, as it ought to be, very jealous in exacting the strict and thorough performance of these duties, and it is in the scrutiny of possible breaches of them that the rigid rules which govern trustees have been applied. It is not enough to exculpate a director that no actual dishonesty can be shown; that he can not be positively proved to have been influenced by interested motives. *Morse, Banks*, pp. 113, 114. Mr. Morawetz, in his work on Private Corporations, says, as to the degree of care to be exercised (section 552): "Attempts have been made to define the degree of care and prudence which directors must exercise in the performance of their duties. In some of the cases it has been said that inasmuch as directors are usually not paid for their services, they are to be regarded as mandataries—persons who have gratuitously undertaken to perform certain duties, and are bound to exercise only ordinary care and prudence—and that they are liable to the corporation only for what is called *crassa negligentia*, or gross negligence. But all this is, at the best, misleading. The plain and obvious rule is that directors impliedly undertake to use as much diligence and care as the proper performance of the duties of their office requires. What



constitutes a proper performance of the duties of a director is a question of fact which must be determined in each case in view of all the circumstances; the character of the company, the condition of its business, the usual methods of managing such companies, and all other relevant facts must be taken into consideration. It is evident that no abstract reasoning can be of service in reaching a proper solution."

Directors, as trustees of a corporation, are bound to manage the affairs of the company with the same degree of care and prudence which is generally exercised by business men in the management of their own affairs. *Hun v. Cary*, 82 N. Y. 65; *Charitable Corporation v. Sutton*, 2 Atk. 400; *Litchfield v. White*, 3 Sandf. 545; *Hodges v. Screw Co.*, *supra*. Directors are not merely bound to be honest; they must also be diligent and careful in performing the duties they have undertaken. They can not excuse imprudence on the ground of their ignorance or inexperience, or the honesty of their intentions; and, if they commit an error of judgment through mere recklessness, or want of ordinary prudence and skill, the corporation may hold them responsible for the consequences. See the case of *Hun v. Cary*, 82 N. Y. 65; Earl, J., saying, in delivering the opinion in that case: "One who voluntarily takes the position of director, and invites confidence in that relation, undertakes like a mandatary, with those whom he represents or for whom he acts, that he possesses at least ordinary knowledge and skill, and that he will bring them to bear in the discharge of his duties. Such is the rule applicable to public officers, to professional men and to mechanics, and such is the rule which must be applicable to every person who undertakes to act for another in a situation or employment requiring skill and knowledge; and it matters not that the service is to be rendered gratuitously. These defendants voluntarily took the position of trustees of the bank. They invited depositors to confide to them their savings, and to intrust the safe-keeping and management of them to their skill and prudence. They undertook, not only that they would discharge their duties with proper care, but that they would exercise the ordinary skill and judgment requisite for the discharge of their delicate trust." Directors can never set up as a defense that they were ignorant of a provision of the company's charter or by-laws. See *Spering's Appeal*, *supra*, and the opinion of Chief Justice Greene in *Hodges v. Screw Co.*, *supra*.

We can not better close the discussion upon this question than by citing the case of *Bank v. Bossieux*, 4 Hughes 387, 398, 3 Fed. Rep. 817, much relied on by the learned counsel for the appellant, who says: "This question has been the subject of investigation and judicial determination by the United States Circuit Court for the eastern district of Virginia. Judge Hughes, in an elaborate opinion, stating the law with great force and clearness, exhibiting a thorough and patient examination of all the authorities, held the defendant directors liable upon this ground: 'Gross inattention and negligence, allowing fraud or misconduct on the part of agents, officers, or co-directors, which could have been prevented if they had given ordinary care and atten-



tion to their duties.' Indeed, this opinion is not only the most thorough examination, but the ablest exposition of the law upon the subject the writer has been able to find after examining many authorities, and he might well be content to rest the law of this case upon the opinion of Judge Hughes. In it he reviews the case of Spering's Appeal, and shows that the very principle was declared in that case upon which he found the directors of the Dollar Savings Bank liable. He declares that 'negligence may be of such a character as to amount to fraud.' " Citing Jones' Ex'rs v. Clark, 25 Gratt. 642, 655, and Neal v. Clark, 95 U. S. 707. In that case Judge Hughes says: "It will abundantly appear from authorities and reported cases to be cited in the sequel that the managing officers of corporations are personally liable for the results of gross negligence, or what the jurists call *crassa negligentia*. If by reckless inattention to the duties confided to them by their corporation, frauds and misconduct are perpetrated by officers, agents, and co-directors, which ordinary care on their part would have prevented, then I think it may be said with truth that it is now elementary law, to be found in all the books, that directors are personally liable for the losses resulting. Moreover, all authorities now tend to the conclusion that directors of banks and other moneyed corporations hold the relation to stockholders, depositors, and creditors of trustees to *cestuis que trust*, and as such are personally responsible for frauds and losses resulting from gross negligence and inattention to the duties of their trust." Bank v. Bossieux, 4 Hughes 398; 3 Fed. Rep. 817, and the authorities cited in the opinion.

We will now proceed to briefly review the facts of this case to which this well-established rule of law is to be applied. The question arises in this case as between the directors and the depositors, and not between the directors and the stockholders. The by-laws of this bank prescribed weekly meetings. It is conceded that these were scarcely ever held, the answers admitting that formal meetings were not held. The decree of the circuit court of Alexandria city, that it appears to the court that there has been no such dereliction of duty on the part of the directors, or any of them, as to fix upon them personal responsibility, can not be sustained upon any sound principle whatever. Upon what principle can Andrew Jameison be held not to be personally liable for the acts already detailed concerning him? The commissioner reports that he took \$2,187.33 out of the cash-drawer; that he withdrew without authority the bonds of the bank, deposited elsewhere, caused their sale and appropriated the money to his own use; overdrew his account \$341.64, and in other ways converted to his own use the property of the bank, aggregating \$11,713.97. The passenger railway company was allowed to overdraw its account to the amount of thousands (\$11,321.91) at one time. The notes of the company were discounted to the amount of \$6,500, and at maturity neither protested, renewed, collected, nor sued on, and the overdraft was allowed to increase for a year or more without security, until it reached \$7,530.45, which was entirely lost to the bank, he being the president of this company part of the time, and one of the bank

directors being president of the company the other part of the time in question, while the treasurer of the railway company was the cashier of this savings bank. Stilson was allowed to withdraw the sole valuable security for his note of \$2,000, and that was lost. He lent his brother \$3,311.62 practically without any security, and that was lost, and actually lent him \$1,211.62 a few months before the bank closed its doors; lending to Robert Jameison, with no security, except worthless indorsers, \$2,300, when he had already gone to protest on a note of \$500.

But the co-directors seek to escape responsibility for all this, including the large loss to the Washington and Ohio Railroad, by claiming to have no actual knowledge of it at all. Did they exercise ordinary diligence to inform themselves, as their duty certainly required that they should? They were required to meet weekly by their own by-laws. They did not always meet semi-annually—meeting sometimes once a year, as we have stated. They were in duty bound to cause the books of the bank to be examined at regular intervals. This they never did at all throughout their whole career, nor did they ever call for a statement of their accounts with other banks. Their vaults and their cash-drawer were emptied by illegal abstractions and insolvent loans, and they admit that they never knew it, and pleaded this as their exculpation. The stock subscribed for was not paid up, as has been stated, and yet such part as was paid up was treated as a loan, and interest paid on it, and a large part had never been paid up at the time of the suspension, and some of it has not yet been paid up. Having a bank with so small a nominal capital, with empty vaults, and despoiled cash-drawer, they owed at the suspension of the bank, to depositors who had intrusted to them their money, \$53,063.63, on which they have been able to pay ten per cent. If these directors had any duty to perform whatever towards their depositors, the records of this case do not show its performance. They plead ignorance. One of their number was the president of the Washington and Ohio Railroad in its last hours, and knew its condition, and secured himself; but the notes due the bank were allowed to sleep unprotested, unsecured, unrenewed, uncollected, and unsued on. One of their number was the president of the Alexandria Passenger Railroad Company, and knew its condition. One of their number was the brother of their defaulting debtor, Jameison, who was insolvent at the time of the loan of thousands to him without security. It is difficult to concede that they could have been ignorant of all this. But suppose they were? Their duty required that they should have looked well into all these matters, and if they have negligently trusted them to others, and loss has occurred, should it fall on them, or upon the depositors who had trusted them, and whose trust they had accepted, and to whom they had solemnly promised such care and attention as were to be expected of good business men?

We think the record shows that these directors, and all of them, have been guilty of such negligence in the premises as makes them personally liable for the losses caused by their negligence, and we

are of opinion that the circuit court of Alexandria city erred in holding them exonerated. While this is true, there is nothing in the record which shows any bad faith, or tends to show any dishonesty on the part of some of these gentlemen, who appear to have confided their duties to others and to have been betrayed by them; but this was such negligence as will fix liability upon them, and their act in assuming this attitude of trust and confidence was voluntary, and led to the confidence which has resulted in loss. We are of opinion to reverse the decree of the circuit court of Alexandria city appealed from, and to render such decree here as the said court ought to have rendered.

Fauntleroy, J., concurred in the opinion.

Hinton, J., concurred in the result.

Lewis, P., and Richardson, J., dissented.

*Decree reversed.*

*Note.* See note preceding case. *Accord*, 1902, Winchester v. Howard, 136 Cal. 432, 89 Am. St. R. 153, 69 Pac. 77.

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**Sec. 663. 2. Care required of officers.**

**SWENTZEL v. PENN BANK.<sup>1</sup>**

**1892. IN THE SUPREME COURT OF PENNSYLVANIA. 147 Pa. St. Rep. 140-154.**

[Bill by creditors against the directors and officers of the bank to hold them personally liable for loss of funds due to the misappropriation of its funds by the president, and alleged to have been made possible through the negligence and inattention of the directors.]

MR. JUSTICE PAXSON. This case has been so carefully considered by the learned master and court below, that little remains for us to add. Indeed, in a case of such magnitude, involving a mass of testimony, we can do little more than see that the principles upon which it has been decided below are sound.

Briefly stated, the bill was filed for the purpose of holding the officers and directors of the bank responsible for the losses resulting from its failure. It is claimed that the officers and directors were negligent in their management of the bank's affairs, and that by reason of such negligence the losses occurred.

It is conceded on all sides that the losses and the disastrous failure of the bank were directly traceable to Mr. Riddle, its late president, now deceased. He practically emptied the vaults of the bank in carrying on a gigantic speculation in oil. This was done with the knowledge of the cashier, and the co-operation of one or more clerks or subordinates. It would have been extremely difficult, if not practically

<sup>1</sup> Facts sufficiently stated in the opinion; arguments, master's report and parts of opinions upon other points omitted.

impossible, for any person to have committed such a swindle without the co-operation of someone inside.

The question is whether the directors ought to have known of these transactions, and whether their failure to know what the real plunderer was doing was such negligence on their part as to render them liable to the creditors of the bank.

The Penn Bank closed its doors in May, 1884. It is not too much to say that its failure was a great shock to the business interests of Pittsburg. It was the cause of much excitement; led to a large amount of litigation, much of it directed against the board of directors. As usual in such cases, the current of public opinion was turned against them, and up to the present time they have been defending themselves against hostile litigation. The time has now arrived when the rights of the parties can be considered calmly, and disposed of in disregard of prejudice or popular clamor.

The first question that naturally suggests itself for our consideration is, the extent of the duty which the directors of a bank owe to the stockholders, whom they represent directly, and the creditors, whom they represent indirectly.

Upon this point there is a general misapprehension in the popular mind. This finds expression, after bank failures, in severe condemnation of directors, and a general assertion of the doctrine that their duty requires them to be familiar with all the details of the management. In the popular mind they are held to the rule that they ought to take the same care of the affairs of the bank that they do of their own private business. Even the learned judge below evidently adopted this view, when he said in his opinion:

“If we were to decide the case on first impressions, as to the conclusions of fact to be drawn, and under the decisions cited and rules laid down in the minority opinion in *Briggs v. Spaulding*,<sup>1</sup> we would say there was gross negligence, or want of the ordinary care that a man of fair intelligence would take of his own affairs.”

It can not be the rule that the director of a bank is to be held to the same ordinary care that he takes of his own affairs. He receives no compensation for his services. He is a gratuitous mandatary. His principal business at the bank is to assist in discounting paper, and for that purpose he attends at the bank at stated periods—generally once or twice a week—for an hour or two. The condition of the bank is then laid before him, in order that he may know how much money there is to loan. Once or twice a year there is an examination of the condition of the bank, in which he participates. The cash on hand is counted, the bills receivable and sureties examined, to see whether they correspond with the statement as furnished by the officers. Beyond this he has little to do with either the cash or the books of the bank. They are in the care of salaried officials who are paid for such services, and selected by reason of their supposed integrity and fitness. To expect a director, under such circumstances, to give the affairs of the bank the same care that he takes of his own business is unreasonable, and few responsible men would be willing to serve upon such terms. In

<sup>1</sup> 141 U. S. 132.

the case of a city bank, doing a large business, he would be obliged to abandon his own affairs entirely. A business man generally understands the details of his own business, but a bank director can not grasp the details of a large bank without devoting all his time to it, to the utter neglect of his own affairs.

A vast amount of authority has been cited upon this question, which we do not think it necessary to review. It is sufficient to refer to a few cases only. In *Spering's Appeal*, 71 Pa. 11, the subject is very fully discussed by the late Justice Sharswood, and the rule of ordinary care is laid down. Not, however, the ordinary care which a man takes of his own business, but the ordinary care of a bank director in the business of a bank. Negligence is the want of care according to the circumstances, and the circumstances are everything in considering this question. The ordinary care of a business man in his own affairs means one thing; the ordinary care of a gratuitous mandatary is quite another matter. The one implies an oversight and knowledge of every detail of his business; the other suggests such care only as a man can give in a short space of time to the business of other persons, from whom he receives no compensation.

The same learned judge, in *Maisch v. Savings Fund*, 5 Phila. 30, laid down the rule as follows: "As to the directors, however, receiving no benefit or advantage, they can be considered only as gratuitous mandataries, liable only for fraud or such gross negligence as amounts to fraud." Again, in *Spering's Appeal*, *supra*, he said: "Indeed, as the directors are themselves stockholders, interested as well as all others that the affairs and business of the corporation should be successful, when we ascertain and determine that they have not sought to make any profit not common to all the stockholders, we raise a strong presumption that they have brought to the administration their best judgment and skill."

We may also refer to *Briggs, Receiver, v. Spaulding*, 141 U. S. 132, which goes even further than our own cases upon this point. It does not relieve a director from the consequence of gross negligence in the performance of his duty, but it holds that he is not responsible where he has used the ordinary care which bank directors usually exercise. It is true this was a case of a national bank, but we apprehend that what is negligence on the part of a director of a national bank would, as a general rule, be a negligence by a director of a state bank, and subject to the same liability.

In regard to what is ordinary care, regard must be had to the usages of the particular business. Thus, if the director of a bank performed his duties as such in the same manner as they were performed by all other directors of all other banks in the same city, it could not fairly be said that he was guilty of gross negligence. And care must be taken that we do not hold mere gratuitous mandataries to such a severe rule as to drive all honest men out of such positions. This thought is so well expressed by Sir George Jessel, M. R., in his opinion in *In re Forest of Dean Coal Mining Co.*, 10 Ch. Div. 450, that I give his remarks in full: "One must be very careful in administering the law



of joint-stock companies, not to press so hard on honest directors as to make them liable for these constructive defaults, the only effect of which would be to deter all men of any property, and, perhaps, all men who have any character to lose, from becoming directors of companies at all. On the one hand, I think the court should do its utmost to bring fraudulent directors to account; and, on the other hand, should also do its best to allow honest men to act reasonably as directors. Willful default no doubt includes the case of a trustee neglecting to sue, though he might, by suing earlier, have recovered a trust fund; in that case he is made liable for want of due diligence in his trust. But I think directors are not liable on the same principle."

Holding, then, the rule to be that directors, who are gratuitous mandataries, are only liable for fraud, or for such gross negligence as amounts to fraud, it remains but to apply this principle to the facts of this case.

It is not alleged—it has never been alleged—that the hands of these directors are stained by fraud. The bank was wrecked by its president, with the cashier and some of the clerks aiding and abetting. It was adroitly done, so far as the means were concerned, and it was concealed wholly from the directors. False entries were made in the books, and false accounts, or accounts with fictitious persons, were opened so as to hide the theft. The reports of the bank's condition, made by the president to the directors from time to time, showed it to be in good condition, while in point of fact it was honeycombed with fraud, and its assets squandered in wild speculations. It may be asked, why did not the directors discover this by an examination of the books? The answer is, that, if they had examined every book in the bank, with a single exception, they would not have found the fraud. That exception is the individual ledger. All the frauds were dumped into this book, and appeared nowhere else. The individual ledger contains the accounts of the individual depositors, and this book, by the rules of a large majority of the Pittsburg banks, the directors are not allowed to see. This is a rule of policy on the part of most city banks, and the reason for it is, at least, plausible. A director, largely engaged in business, may have a number of rivals in the same business who are depositors in the bank. If he is permitted to examine their accounts it gives him an advantage and an insight into a rival's affairs that few business men would tolerate. Hence, it is a question with many banks whether to adopt this rule or lose valuable customers, and they generally prefer the former. We are not speaking of the wisdom of the rule, only of its existence, as bearing upon the question of the directors' negligence. Are they to be held to be guilty of gross negligence in not examining a book, which, by the rules of their own bank, and of four-fifths of all the other banks in Pittsburg, the directors were not permitted to see?

Nor do we think the directors were bound to regard the statements submitted to them as false, and the president, cashier and clerks as thieves. They had nothing to arouse suspicion. All of these gentlemen stood high; they were the trusted agents of the corporation, paid for



their services, and regarded in the community in which they lived as honest men.

Aside from this, the directors were among the heaviest stockholders of the bank. They collectively owned a large proportion of it. And so thoroughly were they deceived by the president as to its condition that, when the first stoppage occurred, they not only believed the suspension was temporary, but they showed their faith by their work, and upon their individual credit raised the sum of \$289,000 to enable it to resume. They did not desert the ship like a parcel of drowning rats, but imperiled their private fortunes in an effort to keep it afloat. Under such circumstances it would be an act of gross injustice to hold them liable for the frauds of others, in which they had not participated—of which they had no knowledge—and which have only been brought to light with the aid of experts. We must measure this transaction by the light which these directors had at the time the transaction occurred. It would be unfair to judge them by the calcium light which has been turned on for six years, and which has enabled us to trace at last the sinuous path of Riddle and his confederates in crime, and the means by which this bank has been robbed and plundered. We are of opinion that the master and the court below were right in their conclusion, and the decree is affirmed upon the appeal of the assignee, and the appeal dismissed at his costs. \* \* \*

*Note.* See preceding cases.

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**Sec. 664.** 3. *Ultra vires* transactions.

See *Dexter Savings Bank v. Friend*, 90 Fed. Rep. 703, *supra*, p. 1796.

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**Sec. 665.** B. Statutory liability.  
1. General nature of.

JOHN WINCHESTER, TRUSTEE, APPELLANT, v. HIRAM MABURY ET AL., RESPONDENTS.

1898. IN THE SUPREME COURT OF CALIFORNIA. 122 Cal. Rep. 522-527.

McFARLAND, J. This is an action at law brought by the plaintiff as assignee of some of the creditors of the Savings Bank of San Diego County against Mabury, Howard and Witherby, directors of said bank, for certain sums of money alleged to have been misappropriated by the defendant, Bryant Howard, who was president, treasurer, etc., of the bank, for which it is alleged Mabury and Witherby were liable

under the latter clause of section 3, article xii, of the constitution of the state. That clause reads as follows:

“The directors or trustees of corporations and joint-stock associations shall be jointly and severally liable to the creditors and stockholders for all moneys embezzled or misappropriated by the officers of such corporation or joint-stock association during the term of office of such director or trustee.”

The defendant, Mabury, demurred to the complaint upon various grounds; the demurrer was sustained by the court below, and judgment was rendered for defendants, and from this judgment the plaintiff appeals.

It is conceded that the alleged liability of the respondent rests entirely upon the clause of the constitution above quoted. There has never been any legislation with respect to said constitutional provision. No legislative act has been passed touching any character of action that may be brought under the provision, or defining its meaning, or referring to it in any manner whatever. Conceding, therefore, for the purposes of this case, that the clause of the constitution in question is self-executing, and requires no legislative aid in carrying it into effect, its meaning, the parties who may take advantage of it, and the form of action by which its provisions may be enforced, are all matters of judicial construction. Whether or not the averments in the complaint constitute “misappropriations” within the meaning of the constitution, and as construed in *Fox v. Hale, etc., Co.*, 108 Cal. 422, *et seq.*, need not, under our view of the case, be here determined. There are also some other questions raised by the demurrer which are not necessary to be here discussed. It is stated in the brief of appellant that the court below sustained the demurrer upon the ground that the action should be one in equity and for the benefit of all the creditors; and we think that the demurrer was properly sustained on that ground. The clause in question provides that in case of embezzlement or misappropriation the directors shall be liable “to the creditors and stockholders” for moneys embezzled or misappropriated; and the phrase “the creditors” evidently means all the creditors. For the purposes of this case we need not consider the other phrase “and stockholders;” the moneys embezzled or misappropriated constitute a fund for the benefit of, at least, all the creditors who have been injured by the wrongful acts, and the only proper remedy in such a case is a bill in equity where all the creditors are parties, or are represented, and in which there can be an accounting and equities adjusted, after all the facts have been ascertained.

The equitable principle applicable here is that “as between creditors equality is equity” (*Cavin v. Gleason*, 105 N. Y. 256, 262).

The above view is amply sustained by the authorities, and the rule cited has been held to apply even under statutes imposing liabilities like those here in question, which provide that “a creditor,” or “any creditor,” or “any person,” wronged, etc., may sue. Our attention has not been called to any statutory or constitutional provision exactly like the one here involved, but there have been many decisions under

statutes of states and of congress imposing liabilities of similar character on directors and officers of corporations, and the principles declared in those decisions are equally applicable to the case at bar.

The rule above stated is declared to be law in *Morawetz on Private Corporations*, paragraph 910, and reference is there made to the case of *Hornor v. Henning*, 93 U. S. 228. The syllabus of that case, which correctly states the matter decided, is as follows: "The act of congress (16 Stats. 98) under which certain corporations are organized in the District of Columbia, contain a provision that 'if the indebtedness of any company organized under this act shall at any time exceed the amount of its capital stock, the trustees of such company assenting thereto shall be personally and individually liable for such excess to the creditors of the company.' Held: 1. That an action at law can not be sustained by one creditor among many for the liability thus created, or for any part of it, but that the remedy is in equity. 2. That this excess constitutes a fund for the benefit of all the creditors, so far as the condition of the company renders a resort to it necessary for the payment of its debts." In that case a demurrer had been sustained to the complaint, and Mr. Justice Miller, delivering the opinion of the court, said: "The demurrer raises the right of a single creditor among many of the corporation to bring his separate action at law for his debt, and recover a judgment for it against the trustees, though the allegations of his declaration be true."

After some discussion he says: "Nor can we believe that an act intended for the benefit of the creditors generally, when the bank proves insolvent, can be justly construed in such a manner that any one creditor can appropriate the whole or any part of this liability of the trustees to his own benefit, to the possible exclusion of all or any part of the other creditors. But such may, and probably would, often be the result if any one creditor could sue alone while there were others unsecured. We are of opinion that the fair and reasonable construction of the act is that the trustees who assent to an increase of the indebtedness of the corporation beyond its capital stock are to be held guilty of a violation of their trust; that congress intended that, so far as this excess of indebtedness over capital stock was necessary, they should make good the debts of the creditors who had been the sufferers by their breach of trust; that this liability constitutes a fund for the benefit of all the creditors who are entitled to share in it, in proportion to the amount of their debts, so far as may be necessary to pay these debts. The remedy for the violation of duty as trustees is in its nature appropriate to a court of chancery." He further says: "In the supreme judicial court of Massachusetts, under the identical form of words, which we are construing in the present case, it has been repeatedly decided that the only remedy is a suit in equity, in which all the creditors are parties; and that even in equity one creditor can not sue alone, but must either join the other creditors or bring his action on behalf of himself and all the others. In *Stone v. Chisolm*, 113 U. S. 302, it was held (we quote from the syllabus) as follows:

“A suit in equity is the proper remedy, in the courts of the United States, to enforce the statutory liability of directors to a creditor of the corporation (organized under the act of legislature of South Carolina of December 10, 1869) by reason of the debts of the corporation being in excess of the capital stock. An action at law will not lie.” Although the statute under review there provided that when the officers of a company were liable, “any person to whom they are so liable may have an action against any one or more of said officers,” still it was held that an action at law would not lie, but that a bill in equity was necessary, in which all creditors were made parties. Mr. Justice Matthews, in delivering the opinion of the court, said that the directors liable had a right to have all the facts determined “once for all in a proceeding which shall conclude all who have an adverse interest, and a right to participate in the benefit to result from enforcing the liability. Otherwise, the facts which constitute the basis of liability might be determined differently by juries in several actions, by which some creditors might obtain satisfaction and others be defeated. The evident intention of the provision is that the liability shall be for the common benefit of all entitled to enforce it, according to their interest, an apportionment of which, in case there can not be satisfaction for all, can only be made in a single proceeding to which all interested can be made parties. The case can not be distinguished from that of *Hornor v. Henning*, 93 U. S. 228, the reasoning and result of which we affirm. It is immaterial that in the present case it does not appear that there are other creditors than the plaintiffs in error. There can be but one rule for construing the section, whether the creditors be one or many. To the question certified, therefore, it must be answered that an action at law will not lie, and that the only remedy is by a suit in equity.” *National Bank v. Dillingham*, 147 N. Y. 603, 49 Am. St. Rep. 692, is a case where the question under consideration is fully discussed and decided as above stated. The individual liability of stockholders, and their relation to the creditors of a corporation, are not the same in the state of New York as they are here, and there is some discussion in the opinion in that case which is not relevant here, and it seems to have been held that an action to enforce the liabilities of directors guilty of misconduct could not be maintained until after the usual remedies against the corporation itself had been resorted to, and all those parts of the opinion are not in point here; but it was there held that, in no event, could the liability of the directors be enforced except by suit in equity. The full syllabus of that case, which shows accurately what was decided, is as follows: “The personal liability imposed by the provisions of section 24 of the stock corporation law (laws 1890, ch. 564, as amended by laws 1892, ch. 688), to the effect that the directors of a stock corporation creating or consenting to the creation of any debt of the corporation unsecured by mortgage, in excess of its paid-up capital stock, ‘shall be personally liable therefor to the creditors of the corporation,’ is secondary, and can be resorted to only after the usual remedies against the corporation itself have been exhausted, and then

can be enforced only by a suit in equity where all the creditors and the corporation itself are parties or represented, where an accounting can be had, all the facts ascertained and equities adjusted." (See, also, Orr, etc., *Shoe Co. v. Thompson*, 89 Tex. 501; *Merchants' Bank v. Stevenson*, 10 Gray 232.)

The fact that the language to be construed here is a part of the constitution of the state, and not a statutory provision, makes no difference. The rules of construction by which the meaning of the language is to be ascertained, and the rights and remedies which grow out of it are the same, no matter where the language to be construed is found.

The judgment appealed from is affirmed.

Temple, J., Harrison, J., Garoutte, J., Van Fleet, J., and Henshaw, J., concurred.

*Note.* The statutory liability of officers is usually because of:

1. Failure to file report: See, 1858, *Derrickson v. Smith*, 27 N. J. L. 166; 1896, *State Sav. Bk. v. Johnson*, 18 Mont. 440, 56 Am. St. Rep. 591; 1899, *Witherow v. Slayback*, 158 N. Y. 649, 70 Am. St. Rep. 507; 1900, *Davis v. Mills*, 99 Fed. Rep. (C. C. Conn.) 39.

2. Filing a false report: 1892, *Huntington v. Attrill*, 146 U. S. 657, *infra*, p. 1892.

3. Contracting before the stock is subscribed: 1899, *Kent v. Clark*, 181 Ill. 237.

4. Contracting debts in excess of stock: 1895, *Tradesman Pub. Co. v. Knoxville, etc., Co.*, 95 Tenn. 634, 49 Am. St. Rep. 943; 1895, *National Bank v. Dillingham*, 147 N. Y. 603, 49 Am. St. Rep. 692, note 698.

**Sec. 666.** 2. When contractual and when penal. Enforcement in foreign state.

#### HUNTINGTON V. ATTRILL.<sup>1</sup>

1892. IN THE SUPREME COURT OF THE UNITED STATES. 146 U. S. Rep. 657-689.

[Bill in equity, filed in 1888, in the circuit court of Baltimore city, by Huntington against the Equitable Gas Light Company, a Maryland corporation, and Attrill, his wife and three daughters, to set aside as fraudulent a transfer of stock in the gas company made by Attrill to his wife and daughters, and to charge that stock with the payment of a judgment recovered by the plaintiff against Attrill, upon his liability as a director of the Rockaway Beach Improvement Company, a New York corporation, under the statute of 1875, providing that, "If any certificate or report made, or public notice given by the officers of any such corporation, shall be false in any material representation, all the officers who shall have signed the same shall be jointly

<sup>1</sup> Statement much abridged; arguments, part of opinion of Mr. Justice Gray and dissenting opinion of Chief Justice Fuller omitted.

and severally liable for all the debts of the corporation contracted while they are officers thereof." The bill alleged that the judgment was recovered in 1886, for \$100,240, on a loan made to the improvement company in 1880, at which time and until 1881 Attrill was a director; that June 30, 1880, he knowingly made a false certificate stating the stock of the corporation was wholly paid in, when in truth no part was paid in; and that this company became insolvent in 1880, and was dissolved in 1882, whereby each shareholder by the laws of New York became liable to the amount of stock held by him, which in the case of Attrill was \$340,000, in addition to his liability for all the debts under the false certificate, all of which made him insolvent from March, 1882, until suit was brought. That in 1882 he acquired 1,750 shares in the gas company, which he forthwith transferred to himself as trustee for his wife and daughters, without consideration and with intent to defraud his creditors; that these transfers were made in New York, where the company's principal office was, and were fraudulent by the laws of New York and Maryland; that unless these were set aside, plaintiff would be deprived of his rights; the bill prayed that the transfers might be set aside, the shares brought into court, sold by a trustee and the proceeds applied to payment of plaintiff's claim. One of the daughters demurred to the bill, on the ground that the bill was for the recovery of a *penalty* under the New York statute, and was not enforceable in the courts of another state. The trial court overruled the demurrer, and on appeal the Maryland court of appeals reversed this ruling and dismissed the bill, first, on the ground that the original cause of action being for the recovery of a penalty, and though merged in the judgment, its essential nature was not changed, and so could not be enforced in another state; and second, that if it was not so merged, the statute of limitations barred all further liability. Writ of error was sued out by Huntington, and allowed by the court of appeals of Maryland, upon the ground that the federal question, whether full faith and credit had been given by the courts of Maryland to the New York judgment, was involved.]

MR. JUSTICE GRAY. \* \* \* The question whether due faith and credit were thereby denied to the judgment rendered in another state is a federal question of which this court has jurisdiction on this writ of error. *Green v. Van Buskirk*, 5 Wall. 307, 311; *Crapo v. Kelly*, 16 Wall. 610, 619; *Dupasseur v. Rochereau*, 21 Wall. 130, 134; *Crescent City Co. v. Butchers' Union*, 120 U. S. 141, 146, 147; *Cole v. Cunningham*, 133 U. S. 107; *Carpenter v. Strange*, 141 U. S. 87, 103.

In order to determine this question it will be necessary, in the first place, to consider the true scope and meaning of the fundamental maxim of international law, stated by Chief Justice Marshall in the fewest possible words: "The courts of no country execute the penal laws of another." *The Antelope*, 10 Wheaton 66, 123. In interpreting this maxim there is danger of being misled by the different shades of meaning allowed to the word "penal" in our language.

In the municipal law of England and America the words "penal"



and "penalty" have been used in various senses. Strictly and primarily they denote punishment, whether corporal or pecuniary, imposed and enforced by the state for a crime or offense against its laws. *United States v. Reisinger*, 128 U. S. 398, 402; *United States v. Chouteau*, 102 U. S. 603, 611. But they are also commonly used as including any extraordinary liability to which the law subjects a wrong-doer in favor of the person wronged, not limited to the damages suffered. They are so elastic in meaning as even to be familiarly applied to cases of private contracts, wholly independent of statutes, as when we speak of the "penal sum," or "penalty" of a bond. In the words of Chief Justice Marshall: "In general, a sum of money in gross, to be paid for the non-performance of an agreement, is considered as a penalty, the legal operation of which is to cover the damages which the party in whose favor the stipulation is made may have sustained from the breach of contract by the opposite party." *Taylor v. Sandiford*, 7 Wheat. 13, 17.

Penal laws, strictly and properly, are those imposing punishment for an offense committed against the state, and which, by the English and American constitutions, the executive of the state has the power to pardon. Statutes giving a private action against the wrong-doer are sometimes spoken of as penal in their nature, but in such cases it has been pointed out that neither the liability imposed nor the remedy given is strictly penal.

The action of an owner of property against the hundred to recover damages caused by a mob was said by Justices Willes and Buller to be "penal against the hundred, but certainly remedial as to the sufferer." *Hyde v. Cogan*, 2 Doug. 699, 705, 706. A statute giving the right to recover back money lost at gaming, and if the loser does not sue within a certain time, authorizing a *qui tam* action to be brought by any other person for threefold the amount, has been held to be remedial as to the loser, though penal as regards the suit by a common informer. *Bones v. Booth*, 2 W. Bl. 1226; *Brandon v. Pate*, 2 H. Bl. 308; *Grace v. McElroy*, 1 Allen 563; *Read v. Stewart*, 129 Mass. 407, 410; *Cole v. Groves*, 134 Mass. 471. As said by Mr. Justice Ashurst in the king's bench, and repeated by Mr. Justice Wilde in the supreme judicial court of Massachusetts, "it has been held in many instances that where a statute gives accumulative damages to the party grieved it is not a penal action." *Woodgate v. Knatchbull*, 2 T. R. 148, 154; *Read v. Chelmsford*, 16 Pick. 128, 132. Thus, a statute giving to a tenant ousted without notice double the yearly value of the premises against the landlord, has been held to be "not like a penal law where a punishment is imposed for a crime," but "rather as a remedial than a penal law," because "the act indeed does give a penalty, but it is to the party grieved." *Lake v. Smith*, 1 Bos. & Pul. (N. R.) 174, 179, 180, 181; *Wilkinson v. Colley*, 5 Burrow 2694, 2698. So, in an action given by statute to a traveler injured through a defect in a highway, for double damages against the town, it was held unnecessary to aver that the facts constituted an offense.

or to conclude against the form of the statute, because, as Chief Justice Shaw said: "The action is purely remedial, and has none of the characteristics of a penal prosecution. All damages for neglect or breach of duty operate to a certain extent as punishment, but the distinction is that it is prosecuted for the purpose of punishment and to deter others from offending in like manner. Here the plaintiff sets out the liability of the town to repair and an injury to himself from a failure to perform that duty. The law gives him enhanced damages, but still they are recoverable to his own use, and in form and substance the suit calls for indemnity." *Reed v. Northfield*, 13 Pick. 94, 100, 101. \* \* \*

The provision of the statute of New York, now in question, making the officers of a corporation who sign and record a false certificate of the amount of its capital stock liable for all its debts, is in no sense a criminal or *quasi*-criminal law. The statute, while it enables persons complying with its provisions to do business as a corporation without being subject to the liability of general partners, takes pains to secure and maintain a proper corporate fund for the payment of the corporate debts. With this aim it makes the stockholders individually liable for the debts of the corporation until the capital stock is paid in and a certificate of the payment made by the officers, and makes the officers liable for any false and material representation in that certificate. The individual liability of the stockholders takes the place of a corporate fund until that fund has been duly created, and the individual liability of the officers takes the place of the fund in case their statement that it has been duly created is false. If the officers do not truly state and record the facts which exempt them from liability, they are made liable directly to every creditor of the company who, by reason of their wrongful acts, has not the security for the payment of his debt out of the corporate property, on which he had a right to rely. As the statute imposes a burdensome liability on the officers for their wrongful act, it may well be considered penal, in the sense that it should be strictly construed. But as it gives a civil remedy at the private suit of the creditor only, and measured by the amount of his debt, it is, as to him, clearly remedial. To maintain such a suit is not to administer a punishment imposed upon an offender against the state, but simply to enforce a private right secured under its laws to an individual. We can see no just ground, on principle, for holding such a statute to be a penal law, in the sense that it can not be enforced in a foreign state or country.

The decisions of the court of appeals of New York, so far as they have been brought to our notice, fall short of holding that the liability imposed upon the officers of the corporation by such statutes is a punishment or penalty which can not be enforced in another state. \* \* \*

It is true that the courts of some states, including Maryland, have declined to enforce a similar liability imposed by the statute of another state. But in each of these cases it appears to have been assumed to be a sufficient ground for that conclusion, that the liability was not founded in contract, but was in the nature of a penalty im-

posed by statute, and no reasons were given for considering the statute a penal law in the strict, primary and international sense. *Derrickson v. Smith*, 3 Dutcher (27 N. J. Law) 166; *Halsey v. McLean*, 12 Allen 438; *First National Bank v. Price*, 33 Md. 487.

It is also true that in *Steam Engine Co. v. Hubbard*, 101 U. S. 188, 192, Mr. Justice Clifford referred to those cases by way of argument. But in that case, as well as in *Chase v. Curtis*, 113 U. S. 452, the only point adjudged was that such statutes were so far penal that they must be construed strictly, and in both cases jurisdiction was assumed by the circuit court of the United States, and not doubted by this court, which could hardly have been if the statute had been deemed penal within the maxim of international law. In *Flash v. Conn*, 109 U. S. 371, the liability sought to be enforced under the statute of New York was the liability of a stockholder arising upon contract, and no question was presented as to the nature of the liability of officers.

But in *Hornor v. Henning*, 93 U. S. 228, this court declined to consider a similar liability of officers of a corporation in the District of Columbia as a penalty. See, also, *Neal v. Moultrie*, 12 Georgia 104; *Cady v. Sanford*, 53 Vermont 632, 639, 640; *Nickerson v. Wheeler*, 118 Mass. 295, 298; *Post v. Toledo, etc., Railroad*, 144 Mass. 341, 345; *Wolverton v. Taylor*, 132 Ill. 197; *Morawetz on Corporations* (2d ed.), § 908. \* \* \*

In this view that the question is not one of local, but of international law, we fully concur. The test is not by what name the statute is called by the legislature or the courts of the states in which it is passed, but whether it appears to the tribunal which is called upon to enforce it to be in its essential character and effect a punishment of an offense against the public, or a grant of a civil right to a private person.

In this country the question of international law must be determined in the first instance by the court, state or national, in which the suit is brought. If the suit is brought in a circuit court of the United States it is one of those questions of general jurisprudence which that court must decide for itself, uncontrolled by local decisions. *Burgess v. Seligman*, 107 U. S. 20, 33. *Texas and Pacific Railway v. Cox*, 145 U. S. 593, 605, above cited. If a suit on the original liability under the statute of one state is brought in a court of another state, the constitution and laws of the United States have not authorized its decision upon such a question to be reviewed by this court. *New York Ins. Co. v. Hendren*, 92 U. S. 286; *Roth v. Ehman*, 107 U. S. 319. But if the original liability has passed into judgment in one state, the courts of another state, when asked to enforce it, are bound by the constitution and laws of the United States to give full faith and credit to that judgment, and if they do not, their decision, as said at the outset of this opinion, may be reviewed and reversed by this court on writ of error.

The essential nature and real foundation of a cause of action, indeed, are not changed by recovering judgment upon it. This was directly adjudged in *Wisconsin v. Pelican Ins. Co.*,<sup>1</sup> above cited. The

<sup>1</sup> 127 U. S. 265.

difference is only in the appellate jurisdiction of this court in the one case or in the other.

If a suit to enforce a judgment rendered in one state, and which has not changed the essential nature of the liability, is brought in the courts of another state, this court, in order to determine, on writ of error, whether the highest court of the latter state has given full faith and credit to the judgment, must determine for itself whether the original cause of action is penal in the international sense. The case, in this regard, is analogous to one arising under the clause of the constitution which forbids a state to pass any law impairing the obligation of contracts, in which, if the highest court of a state decides nothing but the original construction and obligation of a contract, this court has no jurisdiction to review its decision, but if the state court gives effect to a subsequent law, which is impugned as impairing the obligation of a contract, this court has power, in order to determine whether any contract has been impaired, to decide for itself what the true construction of the contract is. *New Orleans Water-Works v. Louisiana Sugar Co.*, 125 U. S. 18, 38. So if the state court, in an action to enforce the original liability under the law of another state, passes upon the nature of that liability and nothing else, this court can not review its decision; but if the state court declines to give full faith and credit to a judgment of another state, because of its opinion as to the nature of the cause of action on which the judgment was recovered, this court, in determining whether full faith and credit have been given to that judgment, must decide for itself the nature of the original liability.

Whether the court of appeals of Maryland gave full faith and credit to the judgment recovered by this plaintiff in New York depends upon the true construction of the provision of the constitution and of the act of congress upon that subject.

The provision of the constitution is as follows: "Full faith and credit shall be given in each state to the public acts, records and judicial proceedings of every other state. And the congress may, by general laws, prescribe the manner in which such acts, records and proceedings shall be proved and the effect thereof." Article 4, section 1.

This clause of the constitution, like the less perfect provision on the subject in the articles of confederation, as observed by Mr. Justice Story, "was intended to give the same conclusive effect to judgments of all the states, so as to promote uniformity, as well as certainty, in the rule among them," and had three distinct objects: First, to declare, and by its own force establish, that full faith and credit should be given to the judgments of every other state; second, to authorize congress to prescribe the manner of authenticating them; and third, to authorize congress to prescribe their effect when so authenticated. *Story on the Constitution*, §§ 1307, 1308.

Congress, in the exercise of the power so conferred, besides prescribing the manner in which the records and judicial proceedings of any state may be authenticated, has defined the effect thereof by en-

acting that "the said records and judicial proceedings so authenticated shall have such faith and credit given to them in every court within the United States as they have by law or usage in the courts of the state from which they are taken." Rev. Stat., § 905, re-enacting act of May 26, 1790, ch. 11, 1 Stat. 122.

These provisions of the constitution and laws of the United States are necessarily to be read in the light of some established principles, which they were not intended to overthrow. They give no effect to judgments of a court which had no jurisdiction of the subject-matter or of the parties. *D'Arcy v. Ketchum*, 11 How. 165; *Thompson v. Whitman*, 18 Wall. 457. And they confer no new jurisdiction on the courts of any state, and, therefore, do not authorize them to take jurisdiction of a suit or prosecution of such a penal nature that it can not on settled rules of public and international law be entertained by the judiciary of any other state than that in which the penalty was incurred. *Wisconsin v. Pelican Ins. Co.*, above cited.

Nor do these provisions put the judgments of other states upon the footing of domestic judgments, to be enforced by execution, but they leave the manner in which they may be enforced to the law of the state in which they are sued on, pleaded or offered in evidence. *McElmoyle v. Cohen*, 13 Pet. 312, 325. But when duly pleaded and proved in a court of that state they have the effect of being not merely *prima facie* evidence, but conclusive proof, of the rights thereby adjudicated; and a refusal to give them the force and effect in this respect which they had in the state in which they were rendered denies to the party a right secured to him by the constitution and laws of the United States. *Christmas v. Russell*, 5 Wall. 296; *Green v. Van Buskirk*, 5 Wall. 307, and 7 Wall. 139; *Insurance Co. v. Harris*, 97 U. S. 331, 336; *Crescent City Co. v. Butchers' Union*, 120 U. S. 141, 146, 147; *Carpenter v. Strange*, 141 U. S. 87.

The judgment rendered by a court of the state of New York, now in question, is not impugned for any want of jurisdiction in that court. The statute under which that judgment was recovered was not, for the reasons already stated at length, a penal law in the international sense. The faith and credit, force and effect, which that judgment had by law and usage in New York, was to be conclusive evidence of a direct civil liability from the individual defendant to the individual plaintiff for a certain sum of money and a debt of record, on which an action would lie, as on any other civil judgment *inter partes*. The court of appeals of Maryland, therefore, in deciding this case against the plaintiff upon the ground that the judgment was not one which it was bound in any manner to enforce, denied to the judgment the full faith, credit and effect to which it was entitled under the constitution and laws of the United States.

*Reversed.*

*Note. Accord:* 1892, *Huntington v. Attrill*, L. R. 18 App. Cas. 150; 1899, *First Nat'l Bank v. Weidenbeck*, 97 Fed. Rep. 896; 1900, *Davis v. Mills*, 99 Fed. Rep. 39.

See note preceding case, and cases, §§ 700, 704, *infra*, and notes.

## ARTICLE II. RIGHTS OF OFFICERS.

**Sec. 667.** 1. To manage corporate affairs within their powers and in good faith without interference by creditors.

See *supra*, §§ 587, 588, and *Pond v. Framingham & L. R. R. Co.*, 130 Mass. 194, *supra*, p. 1808; *Graham v. R. R. Co.*, 102 U. S. 148, *supra*, p. 1809; *Mills v. Northern Ry., etc., Co.*, L. R. 5 Ch. App. 621, *supra*, p. 1813.

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**Sec. 668.** 2. To contract or deal with the corporation.

See *Twin Lick Oil Company v. Marbury*, 91 U. S. 587, *supra*, p. 1750; *Munson v. Syracuse & G. R. Co.*, 103 N. Y. 58, *supra*, p. 1753.

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**Sec. 669.** 3. To obtain a preference as creditor.

See *Olney v. Conanicut Land Co.*, 16 R. I. 597, *supra*, p. 1832; *Howe, Brown, etc., Co. v. Sandford F., etc., Co.*, 44 Fed. Rep. 231, *supra*, p. 1835; *Corey v. Wadsworth*, 118 Ala. 489, *supra*, p. 1836.

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## SUBDIVISION IV. CREDITORS AND SHAREHOLDERS.

## I. RIGHTS OF CREDITORS.

## A. ARISING FROM IMPERFECT INCORPORATION.

**Sec. 670.**

See *Martin v. Fewell*, 79 Mo. 401, *supra*, p. 673; *Fay v. Noble*, 7 Cush. (Mass.) 188, *supra*, p. 677; *Montgomery v. Forbes*, 148 Mass. 249, *supra*, p. 594; *Snider's Sons' Co. v. Troy*, 91 Ala. 224, *supra*, p. 656; *Guckert v. Hacke*, 159 Pa. St. 303, *supra*, p. 662; *Hawes v. Anglo-Saxon Petroleum Co.*, 101 Mass. 385, *supra*, p. 581; *Wechselberg v. Flour City Nat'l Bk.*, 24 U. S. App. 308, *supra*, p. 574; *Curtis v. Tracy*, 169 Ill. 233, *supra*, p. 650; *Metcalf v. Arnold*, 110 Ala. 180, *supra*, p. 97.



## B. COMMON LAW OR EQUITABLE LIABILITY OF SHAREHOLDERS.

## ARTICLE I. ARISING FROM OWNERSHIP OF SHARES.

## Sec. 671. 1. Who are shareholders.

See *supra*, §§ 529-533.

*Note.* 1. Stock books are *prima facie* evidence: *Supra*, §§ 532, 533; note 3 Am. St. Rep. 866; 1896, *Holland v. Duluth Iron Co.*, 65 Minn. 324, 60 Am. St. Rep. 480, note; 1902, *Sherwood v. Trust Co.*, 195 Ill. 112, 88 Am. St. R. 183; 1903, *Earle v. Carson*, 188 U. S. 42.

2. Certificate is not necessary: *Supra*, §§ 529, 530; 1892, *Marson v. Deither*, 49 Minn. 423.

3. One who holds himself out as a member, becomes such by estoppel, as to creditors: 1882, *Wheeler v. Millar*, 90 N. Y. 353; 1899, *Blien v. Rand*, 77 Minn. 110, 79 N. W. Rep. 606; 1900, *Beals v. Buffalo, etc., Co.*, 49 App. Div. (N. Y.) 589. But compare, 1878, *In re Wincham Shipbuilding Co.*, L. R. 9 Ch. D. 329.

4. Holder of shares as collateral security, from the corporation itself, is not a shareholder, though his name is on the corporate books: 1882, *Burgess v. Seligman*, 107 U. S. 20; but if they are so held from another shareholder the collateral holder may be treated as a shareholder: 1897, *State v. Bank of N. E.*, 70 Minn. 398, 68 Am. St. Rep. 538, note, *supra*, p. 1585.

5. As to *transferees* generally, see *supra*, §§ 566, 567 and note, p. 1695. A purchaser of shares (through a broker on the stock exchange) to be sold on a margin, and whose name is not registered on the stock books, is not a shareholder, and is not liable to respond as the holder of unpaid shares: 1892, *Glenn v. Garth*, 133 N. Y. 18.

6. *Corporations* as shareholders. *Private*: See, 1898, *Chemical National Bank v. Havermale*, 120 Cal. 601, 65 Am. St. Rep. 206. See, also, note, *supra*, p. 1064. *Municipal*: See, 1900, *Monongahela Br. Co. v. Pittsburgh*, 196 Pa. 25, 46 Atl. Rep. 99.

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Sec. 672. 2. Creditors have no right, at common law or in equity, to have more than the face value of shares paid up.

TRUSTEES OF THE FREE SCHOOLS IN THE SOUTH PARISH IN  
ANDOVER v. JOHN FLINT.<sup>1</sup>

1847. IN THE SUPREME JUDICIAL COURT OF MASSACHUSETTS. 13  
Metc. (Mass.) Rep. 539-544.

[Assumpsit by the trustees upon a note given by the Andover Mechanic Association, signed by Flint as treasurer, to collect from Flint, as a member of the association, the sum due, for which judgment had been rendered against the association, and execution returned unsatisfied. The corporation was authorized to make by-laws, the eleventh of which provided that "the members pledge themselves in their individual as well as collective capacity to be responsible for all moneys loaned to this association." The plaintiff offered to prove that Flint, while treasurer, had told other creditors that the members

<sup>1</sup> Statement abridged. Part of opinion omitted.

were individually liable, and also by other members, that they considered themselves so liable.]

DEWEY, J. \* \* \* Upon looking at the act incorporating the Andover Mechanic Association (St. 1821, ch. 40) we find it in the usual form of acts of incorporation, giving a corporate name and corporate powers, but imposing no individual liability on its members for the debts of the corporation. Individual liability, as incident to membership of a corporation, arises only from express legislative enactment, either in the charter or by some general law, to which all similar corporations and their individual members are made subject. But there is no general law applicable to this species of corporations, such as exist in reference to manufacturing corporations, or corporations for banking purposes, providing certain liabilities on the individual stockholders of such corporations, in certain specified cases. \* \* \*

The only effect that can be given to this by-law is that of an act or vote of the members of the corporation acting in their corporate capacity. It is not the act of an individual member, nor does the fact of it being found upon the records of the corporation, as a vote duly adopted, authorize the inference that all or that any number greater than a bare majority voted for its adoption. The question then arises, whether it be competent for an aggregate corporation, whose act of incorporation imposes no individual liability upon its members for the debts and contracts of such corporation, to render, by force of by-law, each individual member a guarantor or surety for all moneys lent to the corporation. It is clearly quite foreign from the general purposes and objects, in reference to which by-laws are authorized to be made by corporate bodies. See Rev. Sts., ch. 44, § 2, giving authority to corporations to make by-laws.

It is not, in the opinion of the court, within the corporate powers conferred upon this and similar corporations, to impose upon their members, by any such by-laws, any personal and individual liability to third persons, beyond such as are specified in the charter, or in the general laws of the commonwealth. Such a power would be liable to great abuse, and would subject every member of a corporation, however liberal its charter in excluding individual liability, to be made responsible for the entire indebtedness of the corporation by the act of a majority of those convened at a meeting of such corporation. Take the case of a bank in a doubtful credit, and its active managers deem it useful to sustain it by pledging the individual responsibility of some of its more wealthy stockholders. Can they, by a corporate vote, impose upon all the stockholders a personal liability for all the debts of the corporation? We think not, and are of opinion that each stockholder, by becoming such, subjects himself to no liability beyond that created by the force of the charter itself, or declared by other statutes of the commonwealth. \* \* \*

It is to be borne in mind that these declarations of the defendant were not made to the plaintiffs, but to other persons. The proposed evidence would, therefore, be inadmissible on a trial of this case before a jury, as it would not tend to charge the defendant. Whether

for such false representations he may be held responsible to those to whom he made them, and who may have lent their money upon the faith of them, is a question not now before us. It is a fatal objection to the maintenance of the present action, that the defendant has never, by any valid legal contract, bound himself individually for the payment of the loan made by the plaintiffs to the mechanic association. His name was never subscribed to the pledge of the corporation, that the individual members would guaranty the debts of the corporation. His oral promises, if made, would be inoperative and void, by reason of the statute of frauds. To give any legal effect to these pledges of individual liability, they must have been the individual acts of the members, adopted and sanctioned by them by their signatures under their own hands. Without this the corporate act was a dead letter, and of no binding efficacy upon individual members in their personal capacity.

We see no ground upon which this action can be maintained.

*Judgment for the defendant.*

*Note.* See, 1854, Carr v. Iglehart, 3 Ohio St. 458; 1869, Ireland v. Palestine, etc., Co., 19 Ohio St. 369, *supra*, p. 757; 1875, Upton v. Tribilcock, 91 U. S. 45; 1895, Sampson v. Fox, 109 Ala. 662, 55 Am. St. Rep. 950; 1898, Omaha Law Lib. Assn. v. Connell, 55 Neb. 396; 1899, Sullivan Co. Club v. Butler, 29 Misc. (N. Y.) 306; 1899, Enterprise Ditch Co. v. Moffitt, 58 Neb. 642, 79 N. W. Rep. 560, *supra*, p. 1579; 1900, Woodworth v. Bowles, 61 Kan. 569, 60 Pac. Rep. 331, *infra*, p. 2014; 1900, Johnson Elec. Service Co. v. Detroit Ch. of Com., 124 Mich. 115, 82 N. W. Rep. 795.

**Sec. 673.** 3. Right of creditors to have the full face value of shares paid, if necessary to pay creditors,—general rule.

FLINN, ASSIGNEE, V. BAGLEY ET AL.<sup>1</sup>

1881. IN THE U. S. DISTRICT COURT, E. D. MICHIGAN. 7 Fed. Rep. 785-792.

In equity.

This was a bill in equity by the assignee of the Detroit Novelty Works to compel the payment of the balance due upon certain unpaid subscriptions to the capital stock of the company. The material facts were that the company was organized in 1859, with a capital stock of \$50,000, divided into 2,000 shares of \$25 each. In 1871 it was proposed to increase the stock of the company to \$100,000, and the following agreement was entered into by the defendants in this suit, or by those from whom the defendants hold their stock:

"The undersigned subscribe hereby the amount set opposite our respective names, and agree to pay the same towards the increased stock of the Detroit Novelty Works, in three equal installments, on April 3, 1871, May 3, 1871, and June 3, 1871 (without grace), it being understood that stock shall be is-

<sup>1</sup> Part of opinion omitted.

sued to subscribers for such subscriptions at 66 $\frac{2}{3}$  cents upon the dollar, and that a total amount of the subscriptions hereto shall be \$20,000; and further, that negotiations upon the basis proposed by T. W. Misner, under date of March 31st, shall be completed before these subscriptions shall be of binding force. Detroit, April 1, 1871."

This agreement was assented to by all the existing stockholders of the company, and was carried out by the payment of the money, \$20,000, and the issuance of the stock, \$30,000. The corporation having gone into bankruptcy, and its assets proving insufficient to pay its liabilities, the complainant in the suit, who had been chosen its assignee, filed this bill to compel the defendants, who are stockholders of the company under the above subscription, to pay one-third of the par value of the increased stock taken under that agreement. On July 29, 1874, a majority of the directors of the company filed with the secretary of state the annual report required by the statute, in which it was stated that the amount of capital paid in was \$75,000, and also set forth the names of the stockholders and the number of shares held by each, the aggregate being 4,000 shares, which at \$25 each would be \$100,000.

BROWN, D. J. That the capital stock of a corporation is a trust fund for the payment of its debts, and that the law implies a promise by the subscribers of stock to pay its par value, which in this instance was twenty-five dollars per share, when called for, and that no subsequent release of their original contract or subscription by the corporation will avail against the claims of creditors, are propositions too clearly established to admit of question. But whether a court can not only compel a subscriber to live up to a bargain he has made, but can make another bargain for him, and compel him to live up to that, is a different question. In the case under consideration it is clear that no actual fraud was intended. The novelty works found itself embarrassed for means, and resolved to raise money by increasing its capital stock. As its existing stock, however, was worth only two-thirds of its par value, it was obviously impossible to sell its new stock at par, since all the stock would stand upon an equal footing and no one could be found to pay a dollar for that which was worth but 66 $\frac{2}{3}$  cents. There was, therefore, no recourse but to issue new stock at its real value. All the stockholders of the corporation having assented to this arrangement, it was evidently no fraud upon them, and the corporation itself would be estopped to claim more than the agreed price. Neither was it a fraud upon the existing creditors, since the assets of their debtor were increased by the amount of money actually paid in, and, to that extent, they were benefited by the subscription.

It is, then, only as a fraud upon future creditors that exception can be taken to the transaction. While the statute (Comp. Laws, § 2841) requires the capital stock of such corporations to be divided into shares of twenty-five dollars each, there is no express prohibition against stock being issued for less than its par value. But conceding, upon the authority of *Hawley v. Upton*, 102 U. S. 314, and *Sturges v. Stetson*, 1 Bissell 246, that the directors of a corporation have no right to

issue stock at less than its par value, that the subscription was void, and that an action will lie by the assignee of the corporation against the contributories to compel a surrender of the stock or payment for the same at its real value when the subscription was made, does it follow that a court can compel the subscribers to pay the par value of the shares? Subscriptions to the stock of a corporation are purely a matter of contract. *Sturges v. Stetson*, 1 Biss. 246; *Parker v. North Cent. Mich. R. Co.*, 33 Mich. 23. And where there is an express contract the law will not permit one to be implied. *Cutter v. Powell*, 6 T. R. 320; *Pittsburgh & Connellsville R. Co. v. Stewart*, 41 Pa. 54-58. Undoubtedly when a subscriber originally agrees to take so many shares, the law will imply that he is to pay at the rate of twenty-five dollars per share, and no subsequent release or modification of that agreement by the corporation will prevent creditors from insisting upon full payment. But the English cases hold that if for any reason the subscription be void at all, it is void *in toto*, and that the assignee can not treat it as void to compel a return of the stock and valid to obtain the payment of its par value. It follows from this, that if the contributory agrees only to take paid-up shares he can not be compelled to take unpaid shares. (Citing and quoting from *Currie's Case*, 3 DeG., J. & S. 367; *Carling's Case*, L. R. 1 Ch. Div. 115; *De Ruvigne's Case*, 5 Ch. Div. 306; *Anderson's Case*, 7 Ch. Div. 75, 94.) \* \* \*

These cases appear to be decisive in favor of the position assumed by the defendants here. There is, however, a series of opinions of the supreme court of the United States, beginning with the cases of *Upton v. Tribilcock*, 91 U. S. 45, and culminating in *Hawley v. Upton*, 102 U. S. 314, which put the obligation of the subscriber to stock in an entirely different light. While none of these cases, except the last, are necessarily inconsistent with the views expressed by the English courts, or with the position assumed by the defendants here, the general drift of the opinions is to the effect that the acceptance of a certificate of stock, not fully and actually paid up, *ipso facto*, obligates the holder to make up its par value if the duty of the corporation to its creditors requires it, although he originally agreed to take the stock as fully paid up.

In *Upton v. Tribilcock*, 91 U. S. 45, the defendant agreed to become a stockholder, and, with intent to become such, accepted a certificate for stock whereby he became bound to pay the full amount thereof, as follows: Five per cent. upon the delivery of the certificate, 5 per cent. in three months, 5 per cent. in six months, 5 per cent. in nine months, and residue whenever called for by the company, according to the charter of the company and the laws of the state of Illinois. The defense was that the subscription was obtained by the fraudulent representations of the agents of the company, to the effect that the defendant would only be responsible for 20 per cent. of the subscription made by him, and that he delivered his note in full payment of this amount. He received a certificate with the word "non-assessable" printed across the face. It was held that the legal

effect of the instrument was to make the remaining 80 per cent. payable upon the demand of the company, and that the word "non-assessable" was no qualification of this result. "At the most, the legal effect [is] that the word in question is a stipulation against liability to further taxation or assessment after the holder shall have fulfilled his contract to pay the 100 per cent. in the manner and at the times indicated." In other words, the court adopted the view that the original contract of the subscriber was to pay the par value of the stock, and that the word "non-assessable" did not vary this contract.

While there is nothing in *Chubb v. Upton*, 95 U. S. 665, irreconcilable with the position assumed by the defendants here, Mr. Justice Hunt, in delivering the opinion, observes that when a stockholder receives a certificate of stock for a certain number of shares at a given sum per share, he thereby becomes liable to pay the amount thereof when called upon by the corporation or its assignees. The cases of *Pullman v. Upton*, 96 U. S. 328, and *Hatch v. Dana*, 101 U. S. 205, contain little more than a repetition of the principles laid down in the former cases, and have no especial bearing upon the case under consideration.

The case of *Hawley v. Upton*, 102 U. S. 314, is very nearly, if not directly, in point here. In this case the defendant signed an agreement to the effect that for a consideration of ten shares of the capital stock of the Great Western Insurance Company, received by him, he agreed to pay one-fifth of the par value thereof in installments. His name was entered on the books as a stockholder, but no certificate of stock was ever delivered to him, and no demand ever made upon the company for such certificate. The supreme court held him liable, upon the theory that the company could not sell its stock at less than par, and that his agreement amounted in law to a subscription for the stock and nothing else, and that the receipt of the certificate was not necessary to complete his obligation, as against the creditors of the company. I have sought to find a tenable ground upon which to base a distinction between this case and the one under consideration, but it seems to me that there is no substantial difference between them. Here is an agreement, literally, to subscribe a certain sum and to take in payment therefor a certificate, the par value of which was fixed by law, representing a sum one-third larger than the amount of the subscription. How does this differ from the agreement in *Hawley v. Upton*, by which the defendant acknowledged the receipt of ten shares of stock, the par value of which was also fixed by law, and, in consideration thereof, promised to pay one-fifth of such par value? The whole contract in each case must be taken together. In the one the promise to pay precedes the statement of the consideration, in the other the acknowledgment of the receipt of the consideration precedes the promise to pay, but in legal effect both are agreements to take stock and pay therefor only a percentage of its par value. In neither case does the party agree to pay more if the necessities of the company require, though in the light of these decisions it would seem to make



no difference as against creditors whether he did or not. If, as was said by the chief justice in *Hawley v. Upton*, "All that need be done, so far as creditors are concerned, is that the subscriber shall have bound himself to become a contributor to the fund which the capital stock of the company represents," it is difficult to see why the defendants in this case have not done all that is necessary to make themselves liable for the payment of the amounts claimed. The statement of the court that the suit was not brought on the special agreement of the defendant to pay 20 per cent., but on his general liability as a subscriber to pay for his stock whenever it was wanted to meet the liabilities of the company, is equally applicable when it is made to appear that the defendants received certificates of stock for which they had paid only two-thirds of its par value.

This case is certainly a hard one upon the defendants. Finding the company embarrassed for the want of funds, they agreed to subscribe a certain sum and take in payment stock at what it was really worth. It is clear that no fraud was intended, and that they must be held liable upon an implied agreement to pay more for the benefit of the creditors than they had expressly agreed to pay for the benefit of the corporation. It is a hardship, however, from which I see no way of relieving them consistent with the views of the supreme court in *Hawley v. Upton*, and a decree must, therefore, be entered for the complainant.

*Note.* Unpaid subscriptions.

1. See, generally, note 3 Am. St. Rep. 806, 57 Am. St. Rep. 65; 1840, *Society for Illus. Prac. K. v. Abbott*, 2 Beav. 559; 1853, *Curran v. State of Arkansas*, 15 How. 304; 1867, *Curry v. Scott*, 54 Pa. St. 270; 1873, *Sawyer v. Hoag*, 17 Wall. 610; 1885, *Thompson v. Reno Sav. Bk.*, 19 Nev. 103, 3 Am. St. Rep. 797, note; 1890, *First Nat'l Bank v. Gustin Minerva, etc., Co.*, 42 Minn. 327; 1892, *Hospes v. N. W. Car Co.*, 48 Minn. 174, *infra*, p. 1911; 1894, *In re Ry. Time Tables Pub. Co.*, L. R. (1895) 1 Ch. 255; 1897, *Wallace v. Carpenter Elec. H. & M. Co.*, 70 Minn. 321, 68 Am. St. Rep. 530; 1898, *Maxwell v. Akin*, 89 Fed. Rep. 178; 1898, *Washington Mill Co. v. Lumber Co.*, 19 Wash. 165; 1899, *Cumberland Lumber Co. v. Clinton H. L. Co.*, 57 N. J. Eq. 627, 42 Atl. Rep. 585; 1900, *Fish v. Smith*, 73 Conn. 377, 84 Am. St. Rep. 161, 47 Atl. 711; 1901, *Crowley v. Walton*, — R. I. —, 50 Atl. 385; 1902, *Vermont Marble Co. v. Declez Granite Co.*, 135 Cal. 579, 67 Pac. 1057, 56 L. R. A. 738, 87 Am. St. R. 143.

2. *Set-off*. A shareholder can not set off a claim owing to him by the company against his liability for unpaid subscriptions, in order to pay creditors; he must pay his subscription, and share *pro rata* with creditors: See, 1885, *Thompson v. Reno Sav. Bk.*, 19 Nev. 103, 3 Am. St. Rep. 797, note 806; 1889, *Boulton Carbon Co. v. Mills*, 78 Iowa 460, 5 L. R. A. 649; 1892, *Gilchrist v. Helena & R. Co.*, 49 Fed. Rep. 519; 1894, *Merrill v. Cape Ann Granite Co.*, 161 Mass. 212, 23 L. R. A. 313, note; 1897, *Ball Elec. L. Co. v. Child*, 68 Conn. 522; 1899, *Efird v. Piedmont L. Co.*, 55 S. C. 78, 32 S. E. Rep. 758; 1900, *Wilkinson v. Bertock*, 111 Ga. 187, 36 S. E. Rep. 623; 1899, *Lauraglen Mills v. Ruff*, 57 S. C. 53, 49 L. R. A. 448.

*Contra*: 1895, *Bank v. Bank*, 130 Mo. 155.

3. Creditors of insolvent corporations have no preference to sums due the corporation upon a shareholder's liability over other creditors of any insolvent shareholder. 1897, *Estate of Beard*, 7 Wyo. 104, 75 Am. St. Rep. 882.

4. *Ultra vires* creditors can not enforce their claims against the shareholders, 1902, *Ward v. Joslin*, 186 U. S. 142.

- Sec. 674. Same.** 4. Theories as to the basis of the right.  
(a) Trust-fund doctrine; set-off, statute of limitations.

**SCOVILL v. THAYER.<sup>1</sup>**

**1881. IN THE SUPREME COURT OF THE UNITED STATES. 105 U. S. Rep. 143-159.**

[Error to circuit court, district of Massachusetts. Scovill, as assignee in bankruptcy, sued Thayer to collect sums alleged to be due upon a subscription to the stock of a Kansas mining company. This company had been organized in 1870 with \$100,000 capital stock, which in 1871 was lawfully increased to \$200,000, and afterwards, in 1872, unlawfully increased to \$400,000. Thayer owned 200 shares of the original issue, upon which he had paid \$20 per share; 85 shares of the lawful increase, for which he had paid \$40 per share; and 585 shares of the unlawful increase, for which he had paid \$50 per share. The shares were \$100 in face value, and all the other shareholders had paid like sums on their shares, the balance unpaid credited by "discount," and certificates as for full-paid shares delivered to subscribers, in accordance with the subscription agreement. The corporation became bankrupt. Scovill was appointed assignee by the United States District Court of Kansas and filed his petition therein asking that he be permitted to make an assessment on the shareholders for purpose of paying the corporate debts, amounting to \$124,684 over and above the assets, and alleging that the amount unpaid on the stock was \$222,650, and alleged that an assessment of 76 per cent. on the stock (allowing credits to the extent paid) would equalize the burdens and pay the debts. After hearing in court, an order was made to this effect, and the assignee made the call to be paid August 1, 1876. Thayer having failed to pay, Scovill brought this action at law to collect \$27,160, the amount of the assessment on his unpaid stock. He defended on the ground (1) that the stock unlawfully issued was void; (2) that the sums he had voluntarily paid thereon should be credited as payments on the valid stock; (3) that the two-year statute of limitations barred the claim. The trial court held the claim barred by the statute.]

**MR. JUSTICE WOODS.** \* \* \* (After holding the unlawful issue of stock to be void, and that there were no acts upon the part of Thayer estopping him from asserting its invalidity, proceeds:)

As forcibly suggested by counsel, a creditor who has been defrauded by misrepresentation of the real capital of the company, has his remedy in an action of tort against all who participated in the fraud. But the wrong done to him can not entitle the entire body of creditors, who have not suffered from the alleged fraud, to recover of the entire body of stockholders, who have taken no part in it.

We are of opinion, therefore, that the defendant is not estopped by

<sup>1</sup> Statement abridged; part of opinion omitted.

the acts of the agents and officers of the company to allege the nullity of the overissue stock, and his non-liability to an assessment on such void stock.

The next question for our consideration is whether he is entitled to offset against his liability to pay the sum due on his valid stock the money paid on his void stock.

It is a general rule that a holder of claims against an insolvent corporation can not set them off against his liability for an assessment on his stock in the corporation in a suit by an assignee in bankruptcy. *Sawyer v. Hoag*, 17 Wall. 610; *Sanger v. Upton*, 91 U. S. 56; *Scammon v. Kimball*, 92 U. S. 362; *County of Morgan v. Allen*, 103 U. S. 498.

The ground upon which this rule stands is thus stated by Mr. Justice Miller in *Sawyer v. Hoag*: "The debt which the appellant owed for his stock was a trust fund devoted to the payment of all the creditors of the company. As soon as the company became insolvent, and this fact became known to the appellant, the right of set-off for an ordinary debt to its full amount ceased. It became a fund belonging in equity to all its creditors, and could not be appropriated by the debtor to the exclusive payment of his own claim."

The defendant seeks to avoid the application of this rule to his case, on the ground that the real capital of the company was only \$200,000, and this constituted the trust fund for the security of the debts of the company; that all the money that had been paid in as capital stock had been paid into that fund, and that the party paying any money to that fund was entitled to credit upon his dues thereto.

We can not assent to this view. He was as much bound to know the limits of the charter of the company in which he was a stockholder, as the public or creditors of the company. He knew, therefore, that all stock issued beyond the limit fixed by the charter was absolutely void. When he paid in his money on the void stock, he knew that he was not paying it on valid stock, and he is presumed to have known that it was not a good payment on the valid stock. The company had no right to apply it on the valid stock without his direction. He never directed such application, and it remained in the possession of the company until the rights of the assignees in bankruptcy attached. To say that it was a contribution to the trust fund devoted to the payment of the creditors of the company is an entire misapprehension. It could not be such contribution unless it were a payment on the stock, and this, we have seen, was not the case. No call had been made for payment on the valid stock, to which the amounts paid on the void stock could be said to apply. No call could have been made by the company under its agreement with its stockholders, unless to pay its creditors, and it does not appear that when the payments were made the company had any creditors. It was a voluntary payment for the benefit of the company, and tended to increase the value of the authorized stock. In that way the stockholder got the benefit of it. There is no rule of law or equity which entitles him, in a contest between himself and a creditor of the company, either to receive a

credit for it on his unpaid stock, or to have it repaid to him *pro rata* out of the assets of the company. We are of opinion, therefore, that it could not be offset against the money due on the valid stock held by him.

We are next to consider whether, upon the facts as disclosed by the record, the defense of the statute of limitations should have been sustained. The precise question with which we have to deal is, When would this action at law, brought by the assignees of the bankrupt company against a stockholder, to recover a part of the balance due on his stock, be barred by the statute?

This will depend on the answer to the question, When did the cause of action accrue to the assignees? In other words, When could they have commenced this action against this defendant to recover the amount due on his stock? *Wilcox v. Plummer's Ex'rs*, 4 Pet. 172; *Amy v. Dubuque*, 98 U. S. 470.

The stock held by the defendant was evidenced by certificates of full-paid shares. It is conceded to have been the contract between him and the company that he should never be called upon to pay any further assessments upon it. The same contract was made with all the other shareholders, and the fact was known to all. As between them and the company this was a perfectly valid agreement. It was not forbidden by the charter or by any law or public policy, and as between the company and the stockholders was just as binding as if it had been expressly authorized by the charter.

If the company, for the purpose of increasing its business, had called upon the stockholders to pay up that part of their stock, which had been satisfied "by discount" according to their contract, they could have successfully resisted such a demand. No suit could have been maintained by the company to collect the unpaid stock for such a purpose. The shares were issued as full paid, on a fair understanding, and that bound the company.

In fact, it has been held in recent English cases that not only is the company but its creditors also are bound by such a contract. *Waterhouse v. Jamieson*, Law Rep. 2 H. L. (Sc.) 29; *Currie's Case*, 3 De G., J. & S. 367; *Carling, Hespeler, and Walsh's Cases*, 1 Ch. D. 115.

But the doctrine of this court is, that such a contract, though binding on the company, is a fraud in law on its creditors, which they can set aside; that when their rights intervene and their claims are to be satisfied, the stockholders can be required to pay their stock in full. *Sawyer v. Hoag, Assignee*, 17 Wall. 610; *New Albany v. Burke*, 11 Wall. 96; *Burke v. Smith*, 16 Wall. 390.

The reason is that the stock subscribed is considered in equity as a trust fund for the payment of the creditors. *Wood v. Dummer*, 3 Mason 308; *Mumma v. Potomac Co.*, 8 Pet. 281; *Ogilvie v. Knox Insurance Co.*, 22 How. 387; *Sawyer v. Hoag, supra*. It is so held out to the public, who have no means of knowing the private contracts made between the corporation and its stockholders. The creditor has, therefore, the right to presume that the stock subscribed has been

or will be paid up, and if it is not, a court of equity will at his instance require it to be paid.

In this case the managers and agents of the bankrupt company had in effect represented to the public that all its capital stock had been subscribed for, and had been or would be paid in full. Considered, therefore, in the view of a court of equity, the contract between the company and its stockholders was this, namely, that the stockholders should pay, say, for example, twenty dollars per share on their stock and no more, unless it became necessary to pay more to satisfy the creditors of the company, and when the necessity arose and the amount required was ascertained, then to make such additional payment on the stock as the satisfaction of the claims of creditors required.

When the company was adjudicated a bankrupt, the assignees were bound by this contract, thus equitably construed. Their duty was to collect a sufficient sum upon the unpaid stock, which, with the other assets of the company, would be sufficient to satisfy the company's creditors. They were authorized to collect no more. If it should turn out that the other assets were sufficient, no action would lie against the stockholder for the balance due on his stock. For if in a bankruptcy proceeding any surplus remained after payment of debts, it would go to the company and not to the stockholders. And we have seen that the company in this case would have no right to any surplus.

The question for solution is, therefore, when, under the facts of this case, did the cause of action accrue against the defendant in error? Certainly not until it became his duty to pay according to the terms of his contract or according to law.

It is well settled that when stock is subscribed to be paid upon call of the company, and the company refuses or neglects to make the call a court of equity may itself make the call, if the interests of the creditors require it. The court will do what it is the duty of the company to do. *Curry v. Woodward*, 53 Ala. 371; *Robinson v. Bank of Darien, etc.*, 18 Ga. 65; *Ward v. Griswoldville Manufacturing Co.*, 16 Conn. 593. But under such circumstances, before there is any obligation upon the stockholder to pay without an assessment and call by the company, there must be some order of a court of competent jurisdiction, or, at the very least, some authorized demand upon him for payment. And it is clear that the statute of limitations does not begin to run in his favor until such an order or demand. *Van Hook v. Whitlock*, 3 Paige (N. Y.) 409; *Salisbury v. Black's Adm'r*, 6 Har. & J. (Md.) 293; *Sinkler v. The Turnpike Company*, 3 Pa. 149; *Walter v. Walter*, 1 Whart. (Pa.) 292; *Quigg v. Kirtledge*, 18 N. H. 137; *Nimmo v. Walker*, 14 La. Ann. 581.

In this case there was no obligation resting on the stockholder to pay at all until some authorized demand in behalf of creditors was made for payment. The defendant owed the creditors nothing, and he owed the company nothing, save such unpaid portion of his stock as might be necessary to satisfy the claims of the creditors. Upon

the bankruptcy of the company his obligation was to pay to the assignees, upon demand, such an amount upon his unpaid stock as would be sufficient, with the other assets of the company, to pay its debts. He was under no obligation to pay any more, and he was under no obligation to pay anything until the amount necessary for him to pay was at least approximately ascertained. Until then his obligation to pay did not become complete.

But not only was it necessary that the amount required to satisfy creditors should be ascertained, but that the agreement between the company and the stockholder to the effect that the latter should not be required to make any further payments on his stock should be set aside as in fraud of creditors. No action at law would lie to recover the unpaid balance due on the stock until this was done. The proceeding for an assessment in the bankruptcy court was in effect a proceeding to accomplish two purposes: First, to set aside the contract between the company and the stockholder; and, second, to fix the amount which he should be required to pay. Until these things were done, the cause of action against the stockholder did not accrue, although his primary obligation was assumed at the time when he subscribed the stock.

It appears from the petition of the assignees for an assessment upon the stock of the bankrupt company that they had used due diligence to ascertain what additional payments on the stock would be required to pay off the claims of creditors; that at as early a time as possible they applied to the court for an order directing that the stockholders should pay a part of the amount due on their shares of stock, and assessing the stock therefor; that the order was made accordingly, and within five months thereafter this action at law was begun to enforce its payment.

If, therefore, the right to bring this suit did not accrue to the assignees until the assessment was made upon the stock by the court, and the stockholders were required to pay it, the action was brought long before the limitation of the statute could bar it. \* \* \*

*Reversed.*

Mr. Justice Field and Mr. Justice Gray dissented.

*Accord*, 1903, *Shields v. Hobart*, 172 Mo. 491, 95 Am. St. R. 529, 72 S. W. 669; *contra*, 1900, *Hall v. Henderson*, 134 Ala. 455, 63 L. R. A. 673.

**Sec. 675. Same.**

(b) Fraud in equity.

**HOSPES v. NORTHWESTERN MANUFACTURING AND CAR CO.<sup>1</sup>**

1892. IN THE SUPREME COURT OF MINNESOTA. 48 Minn. 174.

**MITCHELL, J.** This appeal is from an order overruling a demurrer to the so-called "supplemental complaint" of the Minnesota Thresher Manufacturing Company. The Northwestern Manufacturing and Car Company was a manufacturing corporation organized in May,

<sup>1</sup> Part of opinion and arguments omitted.



1882. Upon the complaint of a judgment creditor (Hospes & Co.), after return of execution unsatisfied, judgment was rendered in May, 1884, sequestrating all its property, things in action, and effects, and appointing a receiver of the same. This receivership still continues, the affairs of the corporation being not yet fully administered; but it appears that it is hopelessly insolvent, and that all the assets that have come into the hands of the receiver will not be sufficient to pay any considerable part of the debts. The Minnesota Thresher Manufacturing Company, a corporation organized in November, 1884, as creditor, became a party to the sequestration proceeding, and proved its claims against the insolvent corporation. In October, 1889, in behalf of itself and all other creditors who have exhibited their claims, it filed this complaint against certain stockholders (these appellants) of the car company in pursuance of an order of court allowing it to do so, and requiring those thus impleaded to appear and answer the complaint. The object is to recover from these stockholders the amount of certain stock held by them, but alleged never to have been paid for. \* \* \*

The principal question in the case is whether the complaint states facts showing that the thresher company, as creditor, is entitled to the relief prayed for; or in other words, states a cause of action. Briefly stated, the allegations of the complaint are that on May 10, 1882, Seymour, Sabin & Co. owned property of the value of several million dollars, and a business then supposed to be profitable. That, in order to continue and enlarge this business, the parties interested in Seymour, Sabin & Co., with others, organized the car company, to which was sold the greater part of the assets of Seymour, Sabin & Co. at a valuation of \$2,267,000, in payment of which there were issued to Seymour, Sabin & Co. shares of the preferred stock of the car company of the par value of \$2,267,000, it being then and there agreed by both parties that this stock was in full payment of the property thus purchased. It is further alleged that the stockholders of Seymour, Sabin & Co., and the other persons who had agreed to become stockholders in the car company, were then desirous of issuing to themselves, and obtaining for their own benefit, a large amount of common stock of the car company, "without paying therefor, and without incurring any liability thereon or to pay therefor;" and for that purpose, and "in order to evade and set at naught the laws of this state," they caused Seymour, Sabin & Co. to subscribe for and agree to take common stock of the car company of the par value of \$1,500,000. That Seymour, Sabin & Co. thereupon subscribed for that amount of the common stock, but never paid therefor any consideration whatever, either in money or property. That thereafter these persons caused this stock to be issued to D. M. Sabin as trustee, to be by him distributed among them. That it was so distributed without receipt by him or the car company from any one of any consideration whatever, but was given by the car company and received by these parties entirely "gratuitously." The car company was, at this time, free from debt, but afterwards became indebted to various persons for about \$3,000,000. The thresher company, incorporated after the in-

solvency and receivership of the car company, for the purpose of securing possession of its assets, property, and business, and therewith engaging in and continuing the same kind of manufacturing, prior to October 27, 1887, purchased and became the owner of unsecured claims against the car company, "*bona fide*, and for a valuable consideration," to the aggregate amount of \$1,703,000. As creditor, standing on the purchase of these debts, which were contracted after the issue of this "bonus" stock, the thrasher company files this complaint to recover the par value of the stock as never having been paid for. The complaint does not allege what the consideration of these debts was, nor to whom originally owing, nor what the intervener paid for them, nor whether any of the original creditors trusted the car company on the faith of the bonus stock having been paid for. Neither does it allege that either the thrasher company or its assignors were ignorant of the bonus issue of stock, nor that they or any of them were deceived or damaged in fact by such issue, nor that the bonus stock was of any value. Neither is there any traversable allegation of any actual fraud or intent to deceive or injure creditors. A desire to get something without paying for it, and actually getting it, is not fraudulent or unlawful if the donor consents, and no one else is injured by it; and the general allegation that it was done "in order to evade and set at naught the laws of the state" of itself amounts to nothing but a mere conclusion of law. As a creditors' bill, in the ordinary sense, the complaint is manifestly insufficient. The thrasher company, however, plants itself upon the so-called "trust-fund" doctrine that the capital stock of a corporation is a trust fund for the payment of its debts; its contention being that such a "bonus" issue of stock creates, in case of the subsequent insolvency of the corporation, a liability on part of the stockholder in favor of creditors to pay for it, notwithstanding his contract with the corporation to the contrary.

This "trust-fund" doctrine, commonly called the "American doctrine," has given rise to much confusion of ideas as to its real meaning, and much conflict of decision in its application. To such an extent has this been the case that many have questioned the accuracy of the phrase, as well as doubted the necessity or expediency of inventing any such doctrine. While a convenient phrase to express a certain general idea, it is not sufficiently precise or accurate to constitute a safe foundation upon which to build a system of legal rules. The doctrine was invented by Justice Story in *Wood v. Dummer*, 3 Mason 308, which called for no such invention, the fact in that case being that a bank divided up two-thirds of its capital among its stockholders without providing funds sufficient to pay its outstanding billholders. Upon old and familiar principles this was a fraud on creditors. Evidently all that the eminent jurist meant by the doctrine was that corporate property must be first appropriated to the payment of the debts of the company before there can be any distribution of it among stockholders,—a proposition that is sound upon the plainest principles of common honesty. \* \* \* Citing and quoting from *Fogg v. Blair*, 133 U. S. 534, 541; *Graham v. LaCrosse & M. R. Co.*, 102

U. S. 148; *Wabash, etc., R. Co. v. Ham*, 114 U. S. 587, 5 Sup. Ct. Rep. 1081; *Clark v. Bever*, 139 U. S. 96, 110, 11 Sup. Ct. Rep. 468.

There is also much confusion in regard to what the "trust-fund" doctrine applies. Some cases seem to hold that unpaid subscribed capital is a trust fund, while other assets are not,—that is, so long as the subscription is unpaid, it is held in trust by the corporation, but, when once paid in, it ceases to be a trust fund; while other cases hold that, paid or unpaid, it is all a trust fund. \* \* \* Citing and quoting from *Sawyer v. Hoag*, 17 Wall. 610; *Upton v. Tribilcock*, 91 U. S. 45; *Sanger v. Upton*, 91 U. S. 56; *County of Morgan v. Allen*, 103 U. S. 498, 508.

The capital (not the mere share certificates) means all the assets, however invested. If a subscriber gives his note for his stock, that note is no more and no less a trust fund than the money would have been if he had paid cash down. Capital can not change from a trust to not a trust by a mere change of form. It is either all a trust or all not a trust, and the "trust-fund" rule, whatever that be, must apply to all alike, and in the same way. If the assets of a corporation are given back to stockholders, the result is the same as if the shares had been issued wholly or partly as a bonus. The latter is merely a short cut to the same result. So with dividends paid out of the capital, voluntary conveyances, stock paid in overvalued property; all are forms of one and the same thing, all reaching the same result (a disposition of corporate assets,) which may or may not be a fraud on creditors, depending on circumstances. This much being once settled, the solution of the question when a subsequent creditor can insist on payment of stock issued as paid up, but not in fact paid for, or not paid for at par, becomes, as we shall presently see, comparatively simple.

Another proposition which we think must be sound is that creditors can not recover on the ground of contract when the corporation could not. The right to recover in such cases must rest on the ground that the acts of the stockholders with reference to the corporate capital constitutes a fraud on their rights. We have here a case where the contract between the corporation and the takers of the shares was specific that the shares should not be paid for. Therefore, unlike many of the cases cited, there is no ground for implying a promise to pay for them. The parties have explicitly agreed that there shall be no such implication by agreeing that the stock shall not be paid for. In such a case the creditors undoubtedly may have rights superior to the corporation, but these rights can not rest on the implication that the shareholder agreed to do something directly contrary to his real agreement, but must be based on tort or fraud, actual or presumed. In England, since the act of 1867, there is an implied contract created by statute that "every share in any company shall be deemed and be taken to have been issued and to be held subject to the payment of the whole amount thereof in cash." This statutory contract makes every contrary contract void. Such a statute would be entirely just to all, for every one would be advised of its provisions, and could conduct him-

self accordingly. And in view of the fact that "watered" and "bonus" stock is one of the greatest abuses connected with the management of modern corporations, such a law might, on grounds of public policy, be very desirable. But this is a matter for the legislature, and not for the courts. We have no such statute; and, even if the law of 1873, under which the car company was organized, impliedly forbids the issue of stock not paid for, the result might be that such issue would be void as *ultra vires*, and might be canceled, but such a prohibition would not of itself be sufficient to create an implied contract, contrary to the actual one, that the holder should pay for his stock.

It is well settled that an equity in favor of a creditor does not arise absolutely and in every case to have the holder of "bonus" stock pay for it contrary to his actual contract with the corporation. Thus no such equity exists in favor of one whose debt was contracted prior to the issue, since he could not have trusted the company upon the faith of such stock. *First Nat. Bank v. Gustin Min. Co.*, 42 Minn. 327, 44 N. W. Rep. 198; *Coit v. Amalgamating Co.*, 119 U. S. 343, 7 Sup. Ct. Rep. 231; *Handley v. Stutz*, 139 U. S. 417, 435, 11 Sup. Ct. Rep. 530. It does not exist in favor of a subsequent creditor who has dealt with the corporation with full knowledge of the arrangement by which the "bonus" stock was issued, for a man can not be defrauded by that which he knows when he acts. *First Nat. Bank v. Gustin, etc., Min. Co.*, *supra*. It has also been held not to exist where stock has been issued and turned out at its full market value to pay corporate debts. *Clark v. Bever*, *supra*. The same has been held to be the case where an active corporation, whose original capital has been impaired, for the purpose of recuperating itself, issues new stock, and sells it on the market for the best price obtainable, but for less than par (*Handley v. Stutz, supra*;) although it is difficult to perceive, in the absence of a statute authorizing such a thing (of which every one dealing with the corporations is bound to take notice,) any difference between the original stock of a new corporation and additional stock issued by a "going concern." It is difficult, if not impossible, to explain or reconcile these cases upon the "trust-fund" doctrine, or, in the light of them, to predicate the liability of the stockholder upon that doctrine. *But by putting it upon the ground of fraud, and applying the old and familiar rules of law on that subject to the peculiar nature of a corporation and the relation which its stockholders bear to it and to the public, we have at once rational and logical ground on which to stand. The capital of a corporation is the basis of its credit. It is a substitute for the individual liability of those who own its stock. People deal with it and give it credit on the faith of it. They have a right to assume that it has paid in capital to the amount which it represents itself as having; and if they give it credit on the faith of that representation and if the representation is false, it is a fraud upon them; and, in case the corporation becomes insolvent, the law, upon the plainest principles of common justice, says to*

*the delinquent stockholder, "Make that representation good by paying for your stock." It certainly can not require the invention of any new doctrine in order to enforce so familiar a rule of equity. It is the misrepresentation of fact in stating the amount of capital to be greater than it really is that is the true basis of the liability of the stockholder in such cases; and it follows that it is only those creditors who have relied, or who can fairly be presumed to have relied, upon the professed amount of capital, in whose favor the law will recognize and enforce an equity against the holders of "bonus" stock. This furnishes a rational and uniform rule, to which familiar principles are easily applied, and which frees the subject from many of the difficulties and apparent inconsistencies into which the "trust-fund" doctrine has involved it; and we think that, even when the trust-fund doctrine has been invoked, the decision in almost every well-considered case is readily referable to such a rule.*

It is urged, however, that, if fraud be the basis of the stockholders' liability in such cases, the creditor should affirmatively allege that he believed that the bonus stock had been paid for, and represented so much actual capital, and that he gave credit to the corporation on the faith of it; and it is also argued that, while there may be a presumption to that effect in the case of a subsequent creditor, this is a mere presumption of fact, and that in pleadings no presumptions of fact are indulged in. This position is very plausible, and at first sight would seem to have much force, but we think it is unsound. Certainly any such rule of pleading or proof would work very inequitably in practice. Inasmuch as the capital of a corporation is the basis of its credit, its financial standing and reputation in the community has its source in, and is founded upon, the amount of its professed and supposed capital, and every one who deals with it does so upon the faith of that standing and reputation, although, as a matter of fact, he may have no personal knowledge of the amount of its professed capital, and in a majority of cases knows nothing about the shares of stock held by any particular stockholder, or, if so, what was paid for them. Hence, in a suit by such creditor against the holders of "bonus" stock, he could not truthfully allege, and could not affirmatively prove, that he believed that the defendants' stock had been paid for, and that he gave the corporation credit on the faith of it, although, as a matter of fact, he actually gave the credit on the faith of the financial standing of the corporation, which was based upon its apparent and professed amount of capital. The misrepresentation as to the amount of capital would operate as a fraud on such a creditor as fully and effectually as if he had personal knowledge of the existence of the defendants' stock, and believed it to have been paid for when he gave the credit. For this reason, among others, we think that all that it is necessary to allege or prove in that regard is that the plaintiff is a subsequent creditor, and that, if the fact was that he dealt with the corporation with knowledge of the arrangement by which the "bonus" stock was issued, this is a matter of defense. *Gogebic Inv. Co. v. Iron Chief Min. Co.*, 78 Wis. 427, 47 N. W. Rep. 726.



Counsel cites *Fogg v. Blair*, *supra*, to the proposition that the complaint should have stated that this stock had some value; but that case is not in point, for the plaintiff there was a prior creditor, and, as his debt could not have been contracted on the faith of stock not then issued, he could only maintain his action, if at all, by alleging that the corporation parted with something of value.

In one respect, however, we think the complaint is clearly insufficient. The thrasher company is here asking the interposition of the court to aid in enforcing an equity in favor of creditors against the stockholders by declaring them liable to pay for this stock contrary to their actual contract with the corporation. While the proceeding is not, strictly speaking, an equitable action, yet the relief asked is equitable in its nature. Under such circumstances it was incumbent upon the thrasher company to show its own equities, and that it was in a position to demand such relief. It was not the original creditor of the car company, but the assignee of the original creditors. By that purchase it, of course, succeeded to whatever strictly legal rights its assignors had, but it is not rights of that kind which it is here seeking to enforce. Under such circumstances we think it was incumbent upon it to state what it paid for the claims, or at least to show that it paid a substantial, and not a mere nominal, consideration. The only allegation is that it paid "a valuable consideration." This might have been only one dollar. On this ground the demurrer should have been sustained. \* \* \*

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## Sec. 676. Same.

(c) Fraud at law; joint tort-feasors.

### STEAM STONE-CUTTER CO. v. SCOTT.

1900. IN THE SUPREME COURT OF MISSOURI. 157 Mo. Rep. 520,  
57 S. W. Rep. 1076.

VALLIANT, J. Defendants are sued as stockholders in a dissolved corporation on three notes issued by the corporation to plaintiff. The first count of the petition contains statements to the effect that the defendants organized the corporation with an ostensible capital of \$70,000, divided into 700 shares, which were all taken by themselves, except two shares, given one each to two other persons named, to enable them to organize; the number of shares taken by each defendant is stated, and they aggregate 698; that the articles of association upon which the defendants obtained the charter stated that the full amount of the capital stock was paid in lawful money of the United States, but in truth not more than 10 per cent. of it was paid, and that not in money, but in property conveyed by the defendants to the corporation, and constituted its whole capital stock; that the defendants severally named respectively owe for their stock \$20,340, \$34,550 and \$7,920; "that said property was conveyed to said corporation at a grossly excessive valuation, and was fraudulently and intentionally so



conveyed by said parties to said corporation, with the fraudulent intention on the part of said defendants to organize a corporation with an apparently large capital stock as fully paid up, and thereby obtaining a credit for such corporation to an amount far in excess of what the amount actually paid said corporation on the stock would justify, and with the fraudulent purpose on the part of said defendants by said pretended and sham payment of said stock of exempting themselves from liability to the creditors of said corporation for such unpaid stock as they then and now hold;" that the defendants then fraudulently represented to plaintiff that the stock was paid in full, and thereby induced plaintiff to extend to the corporation the credit which resulted in the debt sued for; that afterwards the corporation was in fact dissolved, leaving the debt unpaid, which in the first count is a note for \$1,094.97, for which judgment is prayed. The second and third counts are like the first, except that each is on a different note, for \$1,000 each. The answer admits the organization of the corporation, denies the other allegations of the petition, and avers that the debts were not to be paid within one year, and that no suit was brought against the corporation within one year after the debt became due. Replication, general denial.

When the cause came on for trial a jury was waived, and it was tried by the court on the pleadings and proof. On the part of the plaintiff there was substantial evidence tending to prove all the allegations of the petition, and on the part of the defendants there was substantial evidence tending to show that their conduct was honest, and that the property conveyed to the corporation was worth the amount of the stock. The court found for the plaintiff on all the issues, and made special findings that at the dissolution of the corporation it was indebted to the plaintiff on the note sued on in the first count in the sum of \$1,425, on that in the second count \$1,565, on that in the third count \$1,565, and in all \$4,555, and that each of the defendants was indebted to the corporation on his stock subscription in an amount in excess of that sum, and judgment against all the defendants for \$4,555 and costs was rendered, from which in due course defendants have appealed. \* \* \*

(After considering effect of statute, proceeds:)

*Besides, under the allegations of the petition and the findings of the court, the defendants are liable independent of the statute, upon the ground that they made false representations upon which they induced the plaintiff to give the credit to the corporation that resulted in the debt sued for. Under that theory, the defendants are jointly and severally liable at common law, although one or more of them may not have been indebted at all to the corporation. \* \* \**

*Affirmed.*

See 1900, *Hall v. Henderson*, 134 Ala. 455, 53 L. R. A. 673; 1903, *Shields v. Hobart*, 172 Mo. 491, 95 Am. St. R. 529, 72 S. W. 669.

**Sec. 677. Same. 5. Exceptions to the general rule.**

(a) By payment of a corporation debt in good faith, by issue of stock.

**DAVID C. VAN COTT, RECEIVER, ETC., RESPONDENT, v. JAMES A. VAN BRUNT, IMPLEADED, ETC., APPELLANT.<sup>1</sup>**

**1880. IN THE COURT OF APPEALS OF NEW YORK. . 82 N. Y. Rep. 535-543.**

**MILLER, J.** The plaintiff, as receiver of the Hudson Avenue Railroad Company, in his complaint claims to recover of the defendant, Van Brunt, and one Slaght, as stockholders of said company, on account of unpaid stock held by them respectively. It is alleged that the defendant Van Brunt was president, director and principal manager, and Slaght director, of said company; that the management of the corporation from the commencement was fraudulent and illegal toward the corporation and its creditors, and an accounting is asked of the assets, debts and liabilities, and of the stock held by said defendants and the amount unpaid thereon; also of the amount of the paid-up capital of the company, and of the debts incurred and owing by the company while the defendants were such directors. It is also demanded that the defendants, as stockholders, may be adjudged to pay up what is unpaid on their stock, or such amount as may be necessary to pay up the debts of the company, and that they may be compelled to pay the excess of debts incurred while they were directors, without their dissent, according to law, over and above three times the amount of capital actually paid up. The special term found, among other things, that defendant Van Brunt, who only appeals—the action having been discontinued as to Slaght, since the interlocutory decree—was the holder of 504 shares of stock, upon which the whole amount of the par value was never paid, and upon which no payments had been made, except that he, being president, made an agreement with one Cowperthwaite to build and equip a portion of the road for a certain sum in stock and for a certain sum in bonds, which contract immediately afterward was assigned to Van Brunt; that the stock and bonds were issued accordingly, and that Van Brunt and others associated with him built and equipped the portion of the road referred to, at an expense less than the amount in stock and bonds prescribed by the contract, and that said Van Brunt has ever since held 475 shares of said stock; that the contract with Cowperthwaite was not made with the intention of being performed by him, but of being transferred to the defendant Van Brunt; and that the arrangement was promoted by the said Van Brunt, as president and director of the company, with a view of enabling the latter, and persons who might associate with him, to build and partially equip a portion of the road and to receive stock and bonds of the company to an amount, at the par value

<sup>1</sup> Arguments and small part of opinion omitted.

thereof, greatly in excess of the actual amount which it would cost or which it was worth.

The court also found that the defendant, Van Brunt, was, at the time of the dissolution of the company, and has since been, also, the holder of twenty-nine other shares of the stock of said company, no part of which had been paid, except twenty-five per cent. on two shares. It was further found that, during the defendant Van Brunt's administration as president and director, stock and bonds were issued to a large amount, and that a greater part of said stock and bonds were diverted from their legitimate use and disposed of by him, in violation of his duty as president and director. As conclusions of law, among others, the court found that the scheme or arrangement for building and equipping of the road was fraudulent against the company and its creditors; that the defendants, as holders of the unpaid stock, were only entitled to have credited, as a payment thereon, the actual outlay paid or incurred for the work and materials, and running stock or equipments, furnished by them in good faith, and held that the defendants were liable for the amount of the unpaid stock held by them.

The important question to be determined in this case is, whether the defendant Van Brunt was liable to pay for the stock held by him, for which he did not actually subscribe, at the par value thereof? Most of the stock was received under the agreement with Cowperthwaite to build and equip a portion of the road, and in consideration thereof. The right of the officers of a railroad corporation to enter into an agreement to build its road and pay for the construction of the same in stock or bonds can not be seriously questioned, and contracts of this description are frequently made for such a purpose. In *Ang. & Ames on Corporations* (§ 590a) it is laid down: "An agreement is often made by railroads to pay the persons building them a certain proportion of the contract-price in stock. Under such a contract the contractor is entitled to the proportion in stock *at its current market value* at the time payment should have been made. And if the stock depreciate so that it has no market value, the amount agreed to be paid in stock must be paid in money." (See *Hart v. Lauman*, 29 Barb. 410; *Moore v. H. R. R. Co.*, 12 Barb. 156; *Porter v. Buckfield Branch R.*, 32 Me. 539.) If a contract can be made to pay in part for building a portion of the road, it may also be made to pay for the whole thereof in like manner; and there is no valid ground for claiming that where the contractor is entitled to stock at its market value, he would be liable for the difference between the market value and the par value thereof. There is no evidence in the record before us to establish affirmatively that the value of the work done and materials furnished was less than the fair and just value of the stock, or that the road built and equipped was worth less than said stock. In fact, the testimony shows that the amount expended exceeded the actual value of the stock and bonds which were received in consideration of the same.

The evidence also established that the stock never had any market

value whatever. It is true that some of the bonds were disposed of at fifty and sixty-five cents upon the dollar and less, and in some instances by throwing in stock to the same amount and one-half more, and in one instance taken at par in part payment of a debt; but they were intrinsically valueless, and after a while were sold for only a nominal sum, until at last no one outside of the company would take either the bonds or stock at any real price. The arrangement for the building of the road was made after full deliberation and consultation, with the knowledge and approval of all the directors and stockholders. It was assented to as the only means furnished, and the only offer which could be obtained from any one to insure the construction of the railroad. It was the best thing which could be done under the circumstances, was entirely satisfactory and made most clearly without any intention to defraud the company or its creditors and in perfect good faith. It is difficult to see how creditors could be defrauded when all the property which the company ever had remained in its possession and under its control. In view of the facts presented no sufficient reason appears why the stock held by Van Brunt and not subscribed for by him should be treated and regarded as full paid-up stock. It was evidently intended by the partners that it should not, and such was manifestly the agreement by which the stock was transferred in payment of the building of a portion of the road. If the rule be once established that no agreement can be made to build railroads by the transfer of stocks or bonds to the contractor, without rendering him liable for the par value thereof, it would seriously interfere with the construction of enterprises of this description, and would prevent the building of many railroads. We are unable to discover any reason why stock and bonds may not be transferred to a contractor to pay for the building of a railroad, where the contract is made in good faith and with no fraudulent intent, although such stock or bonds should prove to be worth even more than the amount allowed for same.

It is claimed that the defendant, as president, director and trustee, having wrongfully appropriated the stock to himself without paying for it, takes all the obligations of a subscriber. This depends upon the question whether the transfer of the stock to the defendant and the application of the same was wrongful. It was done, as we have seen, with the full approval of the stockholders, and in fact was a necessity, and without the contract entered into no portion of the road could have been built. If the defendant had realized a sum beyond the amount actually expended, there might have been, perhaps, some ground for claiming that the arrangement should inure to and for the benefit of the company. As, however, this was not the fact, and no special advantage accrued to the defendant from the contract, and as there is no proof of any fraud, it is not apparent that there was any wrongful appropriation of the stock and bonds, or that the stock and bonds were diverted from their legitimate use. The mere fact that the defendant held a certificate of the stock which was transferred to

him did not make him liable, as it was to all intents and purposes *paid-up* stock. The cases of *Upton v. Tribilcock* (91 U. S. 45), and *Sanger v. Upton* (91 U. S. 56), and the other cases cited by the respondent's counsel, do not sustain the principle that in cases where stock has been transferred in good faith to pay a contractor to build the road, the certificate renders the holder liable to pay for the stock. A number of cases are cited to sustain the position that the liability does not depend upon the subscription. Without examining them, and conceding that this position may be correct, it can not affect the question whether the owners of the stock and bonds which were transferred were liable to pay for the stock as unpaid stock, when it had been disposed of as paid-up stock, for the purpose of building the road. Some cases are cited which involved a question as to the valuation of property received and work done in consideration of the transfer of stock. (See *Boynton v. Hatch*, 47 N. Y. 225; *The Same v. Andrews*, 63 N. Y. 93; *Tallmadge v. Fishkill Iron Co.*, 4 Barb. 382.) All of these relate to the construction of the provisions of the general manufacturing act, and we think none of them are in point.

Section 16 of chapter 282, Session Laws of 1854, which provides for the liability of stockholders for an amount unpaid on stock, is not, we think, applicable where the stock has been disposed of, in good faith and without fraud, to a contractor for building the road. Nor does section 5, 1 R. S., title 3, part 1, chapter 18, which was adopted by the railroad act (chapter 140; § 1, Laws of 1850) relate to any such case. So, also, the provision contained in 2 R. S. 465 (1 Edm. ed.), §§ 45-49, is equally inapplicable where the stock has been fairly appropriated. From the discussion had it follows that the court was wrong in its finding that the arrangement in regard to the contract and its transfer was promoted by Van Brunt as president, to enable him and his associates to build the road and to receive stock and bonds at the par value in excess of the amount which it actually cost or was worth. For the same reason the court erred in holding that the stock and bonds issued were diverted from the legitimate use of the company and disposed of by Van Brunt, in violation of his duty as president and director.

So, also, the conclusion of law was erroneous that the scheme was fraudulent as against the company and against the creditors, and that the defendants were only entitled to credit for the actual outlay paid or incurred, and were liable for the amount unpaid on the stock. The result must be that the defendant was not liable to pay the par value of the stock received by him under the contract for building and equipping a portion of the road.

In regard to the twenty-nine shares which were held by the defendant Van Brunt, and which the court found had not been paid for, except twenty-five per cent. on two shares, it is not important to determine the extent of the defendant's liability on this appeal, as it is

manifest that a new trial must be granted for the reasons already stated. \* \* \*

Reversed.

Earl, J., dissenting.

*Note. Accord:* 1891, *Clark v. Bever*, 139 U. S. 96; 1894, *Bruner v. Brown*, 139 Ind. 600.

See next case and note.

Sec. 678. Same. (b) To save a "going concern."

HANDLEY v. STUTZ.<sup>1</sup>

1891. IN THE SUPREME COURT OF THE UNITED STATES. 139 U. S. Rep. 417-438.

[This was a bill in equity, filed by Stutz and other judgment creditors, on behalf of themselves and such other creditors of the Clifton Coal Company as should come in against that company and certain of its stockholders, to compel an assessment upon certain shares of stock held by the individual defendants, and payment of the same as a trust fund for the satisfaction of the debts of the company. The bill averred in substance that the company was incorporated under the laws of Kentucky in 1883, with power to purchase, lease and operate coal mines in Kentucky, with a capital stock of \$120,000, in shares of \$100 each, with power to increase the same to \$200,000, by a majority vote of the stockholders; that the stockholders, in May, 1886, unanimously increased the stock to \$200,000, being 800 new shares; that of these the defendant Handley subscribed for 86¾ shares, two of the other defendants for 15 shares each, and two others for 75 shares each, certificates of which were issued by the company, and delivered to and received by said subscribers as they were respectively entitled; but that neither one of them ever paid to the company any part of the said shares, and they each, respectively, owe the said company the full par value of the shares of the said capital stock subscribed for and issued to them.

The bill also averred that in 1886, it having been previously resolved to issue bonds to the amount of \$50,000, secured by a mortgage upon its property, the defendants subscribed for bonds of the company aggregating \$50,000, and \$50,000 capital stock was distributed *pro rata* among such subscribers; that said subscribers paid the company for the bonds, and that with the money thus received, to the extent of \$30,000, the company paid its debts to certain of its officers and managers, who had become liable by indorsement for the company, and that nothing was or ever had been paid for or upon any of the shares of capital stock thus subscribed for, and distributed among them.

The bill further averred that the plaintiffs' debts were created be-

<sup>1</sup>Statement abridged. Part of opinion omitted.



fore all of the capital stock of said company was paid in, and that all of said \$80,000 increase of the capital stock, and each and all of the amounts due to the company for any part of its capital stock, constituted a trust fund for their benefit, which they were entitled to have administered in a court of equity to the satisfaction of their said debts, the company being insolvent.

It appeared from the testimony that the company was organized soon after its articles of incorporation were filed, and began business at once, and made large outlays for machinery, buildings, materials and labor. In the early part of 1886 the company was led to believe that its coal would coke, and therefore its products could be profitably extended from grate and steam purposes to iron-making coke. To embark in the manufacture of coke, however, money was needed, and a meeting of the stockholders was held March 31, 1886, at which a resolution was passed, reciting that \$50,000 was needed with which to erect coke ovens, buildings, improvements, etc., to further develop the property; and it was unanimously resolved to issue \$50,000 of bonds of the company, in sums of \$1,000 each, due thirty years from April 1, with six per cent. interest, and secured by trust mortgage upon the property of the company, and the president was authorized to dispose of such bonds as in his discretion seemed best. The mortgage was executed to the designated trustee and recorded. It was found, however, that the bonds could not be sold, and to meet the demands upon the company for money, it borrowed a large amount upon its notes, indorsed by its directors and stockholders, and to secure the lenders and indorsers, the \$50,000 of bonds were deposited in two banks in Nashville, Tennessee, as additional collateral security for the loans. Finding that no one would purchase the bonds, and being advised that in order to effect their sale it would be better to add an equal amount of stock to the bonds, and propose to the purchasers of such bonds to give as a gratuity \$1,000 of stock with each \$1,000 bond, a meeting of the stockholders of the company was held at Nashville, May 31, 1886, at which all the stockholders were present in person or by proxy, although without any call or previous notice, and "it was unanimously resolved that the capital stock of the company be increased to \$200,000, as authorized by the charter." This resolution was not then entered upon the records of the corporation, but was formulated in the shape of a pencil memorandum, and adopted unanimously, although no vote appeared to have been taken, and no formal record was made of the meeting until the summer of 1888. No notice of such change in the amount of its capital stock was recorded or published, as required by the laws of Kentucky. The subscribers to the bonds subsequently executed the agreement set forth in the bill, and bonds to the amount of \$45,000 were delivered to the subscribers with equal amounts of certificates of "paid-up" stock, the receipts reciting that it "was issued with bonds for same amount, as per agreement." The certificates on their face recited that the shares of stock were fully paid up "and were non-assessable," or language to that effect. Five thousand dollars of the bonds were

left in one of the national banks at Nashville as collateral security for a loan to the company, no one having subscribed for them. The remaining \$30,000 shares of increased stock, which were not needed to secure the subscribers to the bonds, appeared to have been distributed *pro rata* among the old stockholders. In the latter part of 1887, and in the early part of the following year, plaintiff obtained judgments against the company, which were unsatisfied, and in September, 1887, by an order of the circuit court of Hopkins county, Kentucky, the entire property of the company was placed in the hands of a receiver, and its operation stopped.

On February 8, 1889, this bill was filed against the coal company and the holders of this increased stock, to compel payment therefor, and to recover the amounts of the judgments against the company. The court dismissed the bill as to three of the defendants not served with process, and as to the rest held them liable to all the creditors of the company whose debts originated after the alleged increase of stock, and fixed May, 1886, as the date of such increase. As to debts contracted prior to that date, they were excluded because, as between the company and the stockholders, the latter held such stock properly, and without liability to the company, and all creditors who dealt with the company prior to such increase, and not upon the faith of such stock, had no equity to demand more than the company itself could. Five of the defendants against whom decrees were rendered in excess of \$5,000 appealed to this court, and the circuit court suspended the execution of the decree as to those who could not appeal until this court should determine the rights of the appellants.

The opinion of the circuit court is reported in 41 Fed. Rep. 531.]

MR. JUSTICE BROWN, J., after deciding the following points: \* \* \*

[1. Although the resolution increasing the stock was not formally entered at that time upon the books of the company, the failure to do so did not affect its validity, as most corporate acts can be proved as well by parol as by written entries. *Moss v. Averell*, 10 N. Y. 449.]

[2. Nor were the proceedings of such meeting any less binding upon those participating in it by reason of the fact that it was held without call or notice and outside the boundaries of the state under the laws of which the company was incorporated. In this case the meeting was attended by all the stockholders but two, who were represented by proxy, the vote increasing the stock was unanimous, and it does not lie in the mouth of those who participated in this act or received the stock voted at this meeting to question its validity.]

[3. It is further claimed that this issue of stock was invalid by reason of the fact that there was no amendment of the charter authorizing such increase ever recorded or published, as required by the law of Kentucky. The statutes of Kentucky require a notice to be published, specifying the amount of capital stock authorized, and provide that no change shall be valid, unless recorded and published as the original articles are required to be.

In the case under consideration, however, the articles of incorporation did provide that the capital stock should be \$120,000, with power

to increase to \$200,000 by a majority vote of the stockholders, and the defect was merely in the failure to record and publish such change, as required by the statute.

We think that the clause upon which reliance is placed must be read in connection with section 18 of the same act, which provides that "no persons, acting as a corporation under the provisions of this act, shall be permitted to set up or rely upon the want of a legal organization as a defense to action brought against them as a corporation; nor shall any person who may be sued on a contract made with such corporation be permitted to rely upon such want of legal organization in his defense." We think this should be regarded as applying to amendments to such organization, and that no defense connected with the original organization, which a party contracting with the corporation would be disqualified to set up, can be made available in connection with an amendment to the original articles.] \* \* \*

So far as the question of liability to the proposed assessments is concerned, these defendants, with respect to their relations to this corporation, are divisible into two distinct classes: *First*, those of the original stockholders who received the \$30,000 increased stock as a gift; *second*, those who subscribed to the \$50,000 bonds and received an equal amount of stock as a bonus or inducement to make the subscription.

4. With regard to the first class, namely, the original stockholders, who voted for this increase of 800 shares, and then distributed among themselves 300 of those shares, without the shadow of right or consideration, it is difficult to see why they should not be called upon to respond for their value. The only claim made upon their behalf is that they never agreed to contribute or pay for the same; that the stock was expressly declared to be "fully paid" and "free from all claims or demands upon the part of the company;" that there was no evidence that the creditors of the company knew of, or relied upon, this increase, in their dealings with the company, and that they had a right to return and surrender the same, which they offered to do. There is no reason to suppose that these stockholders did not act in good faith, and in the belief that they were entitled to this stock. The fact that they did not subscribe for it or agree to take it until the receipt of the certificates is immaterial, as the acceptance of the certificates is sufficient evidence of an agreement to pay their par value. *Sanger v. Upton*, 91 U. S. 56, 64; *Chubb v. Upton*, 95 U. S. 665; *Brigham v. Mead*, 10 Allen 245.

Ever since the case of *Sawyer v. Hoag*, 84 U. S., 17 Wall. 610, it has been the settled doctrine of this court that the capital stock of an insolvent corporation is a trust fund for the payment of its debts; that the law implies a promise by the original subscribers of stock who did not pay for it in money or other property to pay for same when called upon by creditors, and that a contract between themselves and the corporation, that the stock shall be treated as fully paid and non-assessable, or otherwise limiting their liability therefor, is void as against creditors. The decisions of this court upon this subject have

been frequent and uniform, and no relaxation of the general principle has been admitted. *Upton v. Tribilcock*, 91 U. S. 45; *Sanger v. Upton*, 91 U. S. 56; *Webster v. Upton*, 91 U. S. 65; *Chubb v. Upton*, 95 U. S. 665; *Pullman v. Upton*, 96 U. S. 328; *Morgan County v. Allen*, 103 U. S. 498; *Hawkins v. Glenn*, 131 U. S. 319; *Graham v. La Crosse & M. R. Co.*, 102 U. S. 148, 161; *Richardson v. Green*, 133 U. S. 30.

It is simply in affirmance of this general principle that section 14, chapter 56, of the General Statutes of Kentucky, declares that nothing in the act conferring corporate franchises, or permitting the organization of corporations, "shall exempt the stockholders of any corporation from individual liability to the amount of the unpaid installments on stock owned by them." If the corporation has no right, as against creditors, to sell or dispose of this stock with an agreement that no further assessment shall be made upon it, much less has it the right to give it away, or distribute it among shareholders, without receiving a fair equivalent therefor, and thereby induce the public to deal with it upon the credit of such shares, as representing the assets of the corporation. *Union Mutual L. Ins. Co. v. Frear Stone Mfg. Co.*, 97 Ill. 537. The stock of a corporation is supposed to stand in the place of actual property of substantial value, and as being a convenient method of representing the interest of each stockholder in such property, and to the extent to which it fails to represent such value, it is either a deception and fraud upon the public, or an evidence that the original value of the corporate property has become depreciated. The market value of such shares rises with an increase in the value of the corporate assets, and falls in case of loss or misfortune, whereby the value of such assets is impaired. And the increase of value of such stock is taken to represent either an appreciation in value of the company's property beyond the par value of the original shares, or so much money paid to the corporation as is represented by such shares. If it be once admitted that a corporation may issue stock without receiving a consideration therefor, and where it does not represent actual or substituted value in corporate assets, there is apparently no limit to the extent to which the original stock may be "watered," except the caprice of the stockholders. While an agreement that the subscribers or holders of stock shall never be called upon to pay for the same may be good as against the corporation itself, it has been uniformly held by this court not to be binding upon its creditors.

5. Somewhat different considerations apply to those who subscribed for the bonds of the company, with the understanding that they were to receive an amount of stock equal to the bonds as an additional inducement to their subscription. The facts connected with this transaction are substantially as follows: Some three years after the company was organized it became apparent that the enterprise, as originally contemplated, namely, the mining and selling of coal for steam and domestic purposes, was not likely to be a success, owing to the inferior character of the product, and the only hope of the company lay

in the manufacture of the coal into an iron-making coke, that is, a coke containing a percentage of sulphur low enough to admit of the manufacture of merchantable pig-iron. To embark in this, however, money was needed, and as the stock of the company was not worth more than fifty cents on the dollar, it was evident this could not be effected simply by the issue of new stock. It was proposed at the meeting in March that money should be raised by the issue of \$50,000 of bonds, with which to add the requisite structures to the plant. But it was soon evident that the bonds could not be negotiated without the stock, and acting upon the suggestion of a Nashville banker, it was resolved at the meeting in May that the stock should be increased 800 shares, 500 of which should be turned over to the subscribers to the bonds, as a bonus or an additional consideration. The evidence is uncontradicted that the bonds could not have been negotiated without the stock; that they were both sold as a whole; that the transaction was in good faith, and, considering the risk that was taken by the subscribers, the price paid for the stock and bonds was fair and reasonable. The directors appear to have done all in their power to obtain the best possible terms, and there is no imputation of unfair dealing on the part of any one connected with the transaction. At that time the mines and property of the company were in good condition, and the prospects of success were fair.

The case then resolves itself into the question whether an active corporation, or, as it is called in some cases, a "going concern," finding its original capital impaired by loss or misfortune, may not, for the purpose of recuperating itself and providing new conditions for the successful prosecution of its business, issue new stock, put it upon the market and sell it for the best price that can be obtained. The question has never been directly raised before in this court, and we are not, consequently, embarrassed by any previous decisions on the point. In the Upton Cases, arising out of the failure of the Great Western Insurance Company, in *Hatch v. Dana*, 101 U. S. 205, and in *Hawkins v. Glenn*, 131 U. S. 319, the defendants were either original subscribers to the increased stock, at a price far below its par value, or transferees of such subscribers; and the stock was issued, not as in this case, to purchase property or raise money to add to the plant and facilitate the operations of the company, but simply to increase its original stock in order to carry on a larger business, and the stock thus issued was treated as if it formed a part of the original capital. In *Morgan County v. Allen*, 103 U. S. 498, the same principle was applied to a subscription by a county to the capital stock of a railroad company, for which it had issued its bonds, although such bonds had been surrendered to the county with the consent of certain of its creditors.

To say that a corporation may not, under the circumstances above indicated, put its stock upon the market and sell it to the highest bidder, is practically to declare that a corporation can never increase its capital by a sale of shares, if the original stock has fallen below par. The wholesome doctrine, so many times enforced by this court, that



the capital stock of an insolvent corporation is a trust fund for the payment of its debts, rests upon the idea that the creditors have a right to rely upon the fact that the subscribers to such stock have put into the treasury of the corporation, in some form, the amount represented by it; but it does not follow that every creditor has a right to trace each share of stock issued by such corporation, and inquire whether its holder, or the person of whom he purchased, has paid its par value for it. It frequently happens that corporations, as well as individuals, find it necessary to increase their capital in order to raise money to prosecute their business successfully, and one of the most frequent methods resorted to is that of issuing new shares of stock and putting them upon the market for the best price that can be obtained; and so long as the transaction is *bona fide*, and not a mere cover for "watering" the stock, and the consideration obtained represents the actual value of such stock, the courts have shown no disposition to disturb it. Of course no one would take stock so issued at a greater price than the original stock could be purchased for, and hence the ability to negotiate the stock and to raise the money must depend upon the fact whether the purchaser shall or shall not be called upon to respond for its par value. While, as before observed, the precise question has never been raised in this court, there are numerous decisions to the effect that the general rule that holders of stock, in favor of creditors, must respond for its par value, is subject to exceptions where the transaction is not a mere cover for an illegal increase. (Citing and quoting from *New Albany v. Burke*, 11 Wall. 96; *Coit v. Gold Amalgamating Co.*, 119 U. S. 343.)

A case nearer in point is that of *Clark v. Bever*, 139 U. S. 96, decided at the present term of this court. In this case a railroad company, of which defendant's intestate was president and stockholder, had a settlement with a construction company, of which defendant's intestate was also a member, for work done in building the road. The railroad company, being unable to pay the claim of the construction company, delivered to it thirty-five hundred shares of its stock at 20 cents on the dollar, and the same were accepted in full satisfaction of the debt. The stock was not worth anything in the market, and was issued directly to the defendant's intestate. No other payment than the 20 per cent. was ever made on account of this stock. A judgment creditor of the railroad company filed a bill to compel the payment by the defendant of his claim upon the theory that he was liable for the actual par value of such stock, whatever may have been its market value at the time it was received. It was held he could not recover. "Of course, under this view," said Mr. Justice Harlan, in delivering the opinion of the court, "everyone having claims against the railway company—even laborers and employes—who could get nothing except stock in payment of their demands, became bound, by accepting stock at its market value in payment, to account to unsatisfied judgment creditors for its full face value, although at the time it was sought to make them liable, the corporation had ceased to exist, and its stock had remained, as it was when taken, absolutely



worthless. \* \* \* To say that a public corporation, charged with public duties, may not relieve itself from embarrassment by paying its debt in stock at its real value—there being no statute forbidding such a transaction—without subjecting the creditor, surrendering its debt, to the liability attaching to stockholders who have agreed, expressly or impliedly, to pay the face value of stock subscribed by them, is, in effect, to compel them either to suspend operations the moment they become unable to pay their current debts or to borrow money secured by mortgage upon the corporate property.”

So in *Fogg v. Blair*, 139 U. S. 118, also decided at the present term, it was held to be competent for a railroad, exercising good faith, to use its bonds or stock in payment for the construction of its road, although it could not, as against creditors or stockholders, issue its stock as fully paid without getting some fair or reasonable equivalent for it. It was there said: “What was such an equivalent depends primarily upon the actual value of the stock at the time it was contracted to be issued, and upon the compensation which, under all the circumstances, the contractors were equitably entitled to receive for the particular work undertaken or done by them.” It appeared in that case that full and adequate compensation for the work done had been paid by the company in its mortgage bonds, and, as the bill contained no allegation whatever as to the real or market value of such stock, it was held that the contractors receiving this stock were not liable to creditors for its par value. It was added: “If, when disposed of by the railroad company, it was without value, no wrong was done to creditors by the contract made with Blair and Taylor. If the plaintiff expected to recover in this suit on the ground that the stock was of substantial value, it was incumbent upon him to distinctly allege facts that would enable the court—assuming such facts to be true—to say that the contract between the railroad company and the contractors was one which in the interest of creditors ought to be closely scrutinized.” It would seem to follow from this that if the stock had been of some value, that value, however much less than par, would have been the limit of the holder’s liability.

In *Morrow v. Nashville I. S. Co.*, 87 Tenn. 262, the supreme court of Tennessee held that a contract with a subscriber to stock of a corporation, that for every share subscribed he should receive bonds to an equal amount, secured by mortgage on the company’s plant, is void as against creditors, and also between the subscriber and the corporation. But the court drew distinction between such a case and sales of or subscription to the stock of an organized and going corporation. It said: “The necessities of the business of an organized company might demand an increase of capital stock, and if such stock is lawfully issued, it may very well be offered upon special terms. In such case, if the market price was less than par, it is clear that a purchaser or subscriber for such stock at its market value would, in the absence of fraud, be liable only for his contract price. So a case might arise where the stock of a going concern was much depreciated, and where its bonds were likewise below par, and there was lawful

authority to issue additional stock and bonds. Now, in such case, the real market value of an equal amount of stock and bonds might not exceed, or even equal, the par value of either. In such cases, the question of fraud aside, a purchaser would only be held for his contract price." This case from Tennessee puts as an illustration the exact case with which we are now dealing.

The liability of a subscriber for the par value of increased stock taken by him may depend somewhat upon the circumstances under which, and the purpose for which, such increase was made. If it be merely for the purpose of adding to the original capital stock of the corporation, and enabling it to do a larger and more profitable business, such subscriber would stand practically upon the same basis as a subscriber to the original capital. But we think that an active corporation may, for the purpose of paying its debts, and obtaining money for the successful prosecution of its business, issue its stock and dispose of it for the best price that can be obtained. *Stein v. Howard*, 65 Cal. 616. As the company in this case found it impossible to negotiate its bonds at par without the stock, and as the stock was issued for the purpose of enhancing the value of the bonds, and was taken by the subscribers to the bonds at a price fairly representing the value of both stock and bonds, we think the transaction should be sustained, and that the defendants can not be called upon to respond for the par value of such stock, as if they had subscribed to the original stock of the company. Our conclusion upon this branch of the case disposes of it as to those who were held liable by virtue of their subscription to the bonds.

6. We have no doubt the learned circuit judge held correctly that it was only subsequent creditors who were entitled to enforce their claims against these stockholders, since it is only they who could, by any legal presumption, have trusted the company upon the faith of the increased stock. *First Nat. Bank of Deadwood v. Gustin Minerva Con. Min. Co.*, 42 Minn. 327; 2 *Morawetz on Corporations*, §§ 832, 833; *Coit v. North Carolina Gold Amalgamating Co.*, 14 Fed. Rep. 12. We also agree with him that creditors, who became such after the increase was voted in May, 1886, are entitled to look to those who subsequently received the stock, notwithstanding they did not receive it until after the debts had been contracted. The circuit judge found in this connection that the "complainants had no knowledge or notice of the subscription paper of December 30, 1886, under which \$45,000 of the new stock was distributed to those who subscribed for bonds, nor of the distribution among the old stockholders of \$30,000 of said increased stock; nor does it affirmatively appear that they or either of them dealt with and trusted the company upon the faith of that increased stock; but the fact that the capital stock had been increased to \$200,000 was made public and was generally known." The real question in this connection is, when may it be presumed creditors trusted the corporation upon the faith of the increased stock? Obviously, when such increase was ordered. That is a fact to which publicity would naturally be given; the creditors could not be ex-

pected to know when and by whom such stock would be taken. It is true they assume the risk of the stock not being taken at all, but the moment shares are taken they are supposed to represent so much money put into the treasury as they are worth, which becomes available for the payment, not only of future, but of existing creditors. It is manifest that any attempt to gauge the liability of stockholders by the exact time they took their stock with reference to the dates when the several claims of the creditors accrued, and by the further fact whether the creditors actually knew of and relied upon such stock, would in a case like this, where the creditors and stockholders are both numerous, lead to inextricable confusion. Even the flexibility of a court of equity would be inadequate to adjust the rights of the parties. \* \* \*

Reversed.

Mr. CHIEF JUSTICE FULLER, with whom concurred Mr. JUSTICE LAMAR, dissenting:

I dissent from the conclusion of the court in respect of the stock received by the subscribers to the bonds. That stock was not paid for in money or money's worth, or issued in payment of debts due from the company, or purchased at sale upon the market. It was a mere bonus, thrown in with the bonds as furnishing the inducement to the bond subscription, of larger control over the corporation, and of possible gain without expenditure. Becoming secured creditors through the bonds, the subscribers increased their power through the stock. In my view, there was no actual payment for the stock, and to treat it as paid up is to sanction an arrangement to relieve those who would reap the benefit derived from the possession of the stock, in the event of the success, from liability for the consequences, in the event of the failure of the enterprise.

When the capital stock of a corporation has become impaired, or the business in which it has engaged has proven so unremunerative as to call for a change, creditors at large may well demand that experiments at rehabilitation should not be conducted at their risk.

My brother Lamar concurs with me in this dissent.

*Note. Accord:* 1873, *In re H. & M. Tin, etc., Co., Spargo's Case*, L. R. 8 Ch. App. 407; 1875, *In re Western C. Oil Co.*, L. R. 1 Ch. D. 115; 1876, *In re Compagnie Generale, etc.*, 4 Ch. D. 470, 7 Eng. Rul. Cas. 676; 1880, *Van Cott v. Van Brunt*, 82 N. Y. 535, *supra*, p. 1919; 1884, *Stein v. Howard*, 65 Cal. 616, *infra*, p. 1951; 1887, *Christensen v. Eno*, 106 N. Y. 97, *infra*, p. 1933; 1890, *Christensen v. Quintard*, 29 N. Y. St. 61; 1890, *Clark v. Bever*, 139 U. S. 96; 1890, *Fogg v. Blair*, 139 U. S. 118; 1893, *Webb v. Shropshire Rys. Co.*, 63 L. J. Ch. 80, 69 L. T. 533, 7 Eng. Rul. Cas. 382; 1896, *Dummer v. Smedley*, 110 Mich. 466, 68 N. W. Rep. 260. Compare, also, 1892, *Hospes v. N. W. Car Co.*, 48 Minn. 174, *supra*, p. 1911.

*Contra:* 1884, *Haldeman v. Ainslie*, 82 Ky. 395; 1889, *Morrow v. Iron Co.*, 87 Tenn. 262; 1889, *Richardson v. Green*, 133 U. S. 30; 1891, *Camden v. Stuart*, 144 U. S. 104; 1892, *Ooregum Gold M. Co. v. Roper*, App. Cas. H. L. 125, 7 Eng. Rul. Cas. 644; 1893, *In re Ry. Time-Table Pub. Co.*, 68 L. T. 649; 1895, *Coleman v. Howe*, 154 Ill. 458; 1896, *Rickerson v. Farrell*, 43 U. S. App. 452; 1897, *Peter v. Union Co.*, 56 Ohio St. 181; 1902, *Vermont Marble Co. v. Declez Granite Co.*, 135 Cal. 579, 56 L. R. A. 728.

See, also, 1 *Thompson Corp.*, §§ 1579-1582; and Prof. Hufcut, in 26 *Am. Law Rev.*, p. 861; also Mr. Alfred Russell, in 1 *Mich. L. J.* 17, 26 *Am. L. R.* 270.

**Sec. 679. Same. (c)** In a case of gift of shares.

**CHRISTENSEN v. ENO.<sup>1</sup>**

**1887. IN THE COURT OF APPEALS OF NEW YORK. 106 N. Y. Rep. 97-103, 60 Am. Rep. 429.**

[Appeal by Eno from judgment of the supreme court in favor of plaintiff Christensen.]

This action was brought by plaintiff, as judgment creditor of defendant, the Illinois and St. Louis Bridge Company, against it and defendant Eno, among other things, to compel the latter to pay forty per cent. of the par of twenty-five shares of the stock of said company issued by it to him, upon which stock the forty per cent. was not paid, but was credited as paid when the stock was issued; also, to compel said defendant to account for and pay over, in satisfaction of plaintiff's judgment, the proceeds of the sale by him of certain second mortgage bonds gratuitously issued to said Eno as a stockholder by said corporation, upon payment by him of the remaining sixty per cent. of said stock.

ANDREWS, J. The judgment below proceeds on the ground that the forty per cent. credited as paid on the twenty-five shares of stock of the Illinois and St. Louis Bridge Company, issued to the defendant Eno in 1871, but which was not in fact paid, and also the sum of \$5,332.18, realized by him on the sale of second mortgage bonds of the company, received as his share on the distribution of the same among stockholders, pursuant to the resolution of the company of December 20, 1871, were equitable assets in the hands of the defendant Eno, applicable to the payment of the debts of the corporation, and which the plaintiff, as a judgment and execution creditor, may reach in this action and have applied to the satisfaction of his judgment. It is very plain, upon the facts, that the plaintiff in asserting this claim can not stand upon any right existing in the corporation itself to proceed against the defendant Eno. The transactions by which he acquired the shares as paid-up shares to the extent of forty per cent. of their nominal amount, and received the bonds, created no obligation as between him and the company to pay the amount unpaid on the stock or to account to the company for the bonds or their proceeds. As between Eno and the company, it was not intended that the former should be accountable to the company for the amount unpaid on the stock or for the bonds. Viewing the transactions in the light most favorable to the plaintiff, the credit on the stock and the transfer of the bonds were intended as a gratuity to the stockholders who had been called upon to pay calls upon their original subscriptions in excess of what was expected and of what was represented would be necessary at the commencement of the enterprise.

<sup>1</sup> Arguments omitted.

There can be no doubt that as between the corporation and its stockholders these transactions were binding according to the actual intention. The corporation itself would have no standing to demand that the defendant Eno should pay the forty per cent. on the stock which it acknowledged had been paid, or that he should account for the proceeds of the bonds. The claim of the plaintiff, therefore, must be maintained, if at all, not in right of the corporation, or by way of equitable subrogation to any right of the corporation against Eno, but in hostility to the arrangement between them, under which he received the stock and bonds. The plaintiff, to entitle himself to the relief demanded, is compelled to maintain that, as a creditor of the corporation, he has rights superior to those of the corporation itself, and may hold the defendant to account for the unpaid forty per cent. on the stock as though he had been a subscriber therefor, and for the proceeds of the bonds as though he had purchased them of the corporation, or had sold them on its account. So far as respects the claim to recover the forty per cent. unpaid on the twenty-five shares of stock, we understand it is placed, by the learned counsel for the plaintiff, mainly on the proposition that the capital stock of a corporation is a trust fund for the security of creditors, which can not be given away or distributed among stockholders so long as debts of the corporation remain unpaid, and that the transaction in question was a violation of this principle. The general principle asserted is, doubtless, well founded, but if it had an appropriate application in the present case, the plaintiff would encounter some difficulty, under the authorities in this state, in maintaining a separate action as an individual creditor of the corporation, to reach assets which constitute a trust fund, not for the protection of one creditor only, but equally for all the creditors of the corporation. (*Griffith v. Mangam*, 73 N. Y. 611, and cases cited.) But passing this, we are of opinion that the forty per cent. credited on the twenty-five shares of stock issued to the defendant Eno, can not be considered as, and does not constitute, a trust fund applicable to the payment of creditors. The capital of a corporation consists of the funds, securities, credits and property of whatever kind which it possesses. The word "capital" applied to corporations is often used interchangeably with the words "capital stock," and both are frequently used to express the same thing—the property and assets of the corporation. Strictly, the capital stock of a corporation is the money contributed by the corporators to the capital, and is usually represented by shares issued to subscribers to the stock on the initiation of the corporate enterprise. (See *Burrall v. Bushwick R. Co.*, 75 N. Y. 211, 212, and cases cited.)

It may be admitted that the liability of subscribers on unpaid stock subscriptions constitutes an asset of the corporation, which can not be surrendered or given up by the corporation without consideration to the prejudice of creditors. It is not claimed that there is any express prohibition in the charter of the bridge company against issuing shares purporting to be fully paid without actual payment. The charter authorizes books of subscription to the stock to be opened.



The most that could be claimed for this provision is that by implication it prohibits the issue of stock except to actual subscribers, who should undertake to pay the nominal amount of the shares when required. There is no pretense that the defendant Eno ever subscribed for the twenty-five shares of *bonus* stock (so called), or entered into any engagement to pay the forty per cent. credited thereon. This was distinctly contrary to the intention of all parties. The plaintiff seeks to charge him as though he had subscribed for the stock, and entered into a contract obligation with the company to pay the forty per cent. We can see no ground upon which he can be made to respond to the creditors of the company as upon an unpaid subscription. Assuming that the transaction as to the company was *ultra vires*, or that it could not give away its shares, the transaction in that view was simply a nullity, and Eno got nothing as against any one entitled to question the transaction. But it did not convert him into a debtor of the company for the forty per cent. He entered into no contract to pay it. He has received nothing on account of the twenty-five shares, and it is not claimed that the charter in terms imposes the liability claimed.

The unissued shares of a corporation are not assets. When issued they represent a proportionate interest of the shareholder in the corporate property—an interest, however, subordinate to the claims of creditors. There are unquestioned public evils growing out of the creation and multiplication of shares of stock in corporations not based upon corporate property. The remedy is with the legislature. But the liability of a shareholder to pay for stock does not arise out of his relation, but depends upon his contract, express or implied, or upon some statute, and in the absence of either of these grounds of liability, we do not perceive how a person to whom shares have been issued as a gratuity has, by accepting them, committed any wrong upon creditors, or made himself liable to pay the face value of the shares as upon a subscription or contract. (Seymour v. Sturgess, 26 N. Y. 134; In re Western Canada Oil Co., L. R. 1 Ch. Div. 115; Waterhouse v. Jamieson, L. R. 2 H. L. (Sc.) 29.) The question as to the right of the plaintiff to compel the defendant to account for the sum realized by him on the sale of the bonds is affected by the fatal difficulty that the defendant has received nothing from the corporation, except its promise to pay, which has never been performed. The plaintiff has withdrawn nothing from the funds of the company on account of the bonds (unless it may be a sum represented by a single interest coupon) and creditors have not been prejudiced by the transaction.

It is alleged, and it was offered to be proved, that the property of the company had been sold on the foreclosure of the first mortgage. It is unnecessary to consider what the rights or liabilities of the defendant would be in respect to the bonds as between himself and other creditors of the corporation on a distribution of assets, or if it had appeared that the corporation had paid the bonds issued to the defendant. The situation in either of these aspects is not presented.



This is not a case of following assets of a corporation wrongfully transferred. The defendant had received none of the funds or assets of the company available to creditors. The loss on the bonds falls on those who have purchased them relying on the credit of the corporation. The situation of the general creditors has not, so far as appears, been affected by the fact that the company received nothing for the bonds. The statute of Missouri, the state from which the bridge company in part derives its existence, authorizes a creditor of a corporation, who shall have obtained judgment against it, upon which an execution has been returned *nulla bona*, to issue execution thereon against any stockholder to an extent equal in amount to the amount of stock held by him "together with any amount unpaid thereon." The courts of Missouri on an application under this statute for leave to issue execution against a person who was a director and stockholder in the bridge company, who had received bonus stock and bonds, granted the application and came to the conclusion that the forty per cent. credited on the stock could be regarded as the amount unpaid thereon within the statute, and that the amount received on the bonds was also recoverable. (*Skrainka v. Allen*, 7 Mo. App. 434, 435, s. c. 76 Mo. Rep. 384.) The statutory remedy is, of course, not available in this state. (*Lowry v. Inman*, 46 N. Y. 119, 120.) The court seems to have given much weight to the fiduciary and trust relation existing between a director of a corporation and its creditors. That relation did not exist between the defendant Eno and the creditors of the company. He was a stockholder simply, and no trust relation exists between a stockholder and a corporation and its creditors. The decision in Missouri may stand on its special circumstances, but it is not controlling in the case before us.

We are of opinion that the judgment appealed from is erroneous, and that it should, therefore, be reversed and a new trial ordered.

All concur.

Judgment reversed.

Note. See note to preceding case.

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Sec. 680. 6. Payment for shares in property.  
(a) Good-will.

WASHBURN ET AL. V. NATIONAL WALL-PAPER CO. ET AL.<sup>1</sup>

1897. IN THE U. S. CIRCUIT COURT OF APPEALS (N. Y.): 81  
Fed. Rep. 17-24.

This is an appeal from the decree of a circuit court, southern district of New York, dismissing the bill.

The suit was brought by complainants, who are large owners of the stock of the defendants, the National Wall-Paper Company, to restrain the payment of interest upon certain obligations of the company called "debenture

<sup>1</sup> Part of opinion omitted.

stock." The complainants insisted that such payment was not justified by the terms of the debenture stock itself, but was in violation of the agreement between the company and the complainants, and of the provisions of the articles of association and by-laws of the company. The company's president and treasurer were joined as defendants.

The defendant company was organized June 2, 1892, under the New York business corporation law, to carry on the business of manufacturing and dealing in wall paper, with a capital stock originally of \$14,000,000, but which was soon increased to \$30,000,000, all of which, however, has not been issued. The certificate of incorporation provided for the creation of obligations in the nature of certificates of indebtedness to the extent of \$8,000,000, to be known as "debenture stock," and sold for cash or for property, or assets purchased by the corporation at the fair market value thereof. It further provided that: "The debenture stock hereby authorized to be issued shall be and remain an obligation of the corporation, or payable at the expiration of the corporate existence, and entitled meantime to interest at a rate not exceeding eight per cent. per annum, payable quarter-yearly, as an expense of the business, from and out of the profits of the company, before any dividend can be declared or paid on the stock or share capital. No payment of interest can or shall be made on such debenture stock which will impair the capital, nor unless the amount paid shall have been actually earned by the company. The holders of debenture stock shall not be entitled to demand or sue for the interest payable upon the obligations held by them unless such interest was actually earned by the company, in which event the amount earned shall be distributed amongst and paid to the holders of debenture stock, to the proportion of their holdings, but the unpaid interest shall, notwithstanding, become and remain an obligation of the company, payable out of any future profits to the full extent of the amount represented by the outstanding certificates before any dividends can be declared or paid on the stock or share capital. In the event of the dissolution or winding up of the company, the holders of debenture stock or of certificates representing the ownership thereof shall rank *pari passu* with other unsecured creditors of the corporation, and shall be entitled to receive in full out of the assets of the company the amounts represented by the outstanding certificates of indebtedness or debenture stock in priority to the claims of the shareholders to be paid any amount in respect of such shares." The by-laws provided that the board of directors shall select accountants as official auditors to the company, who shall supervise its books of account, and all interest paid upon the debenture stock, and all dividends declared on the share capital, shall be based upon the net earnings of the company as certified by such auditors. Each certificate of debenture stock contained the following provision: "Each of the shares of debenture stock represented by this certificate is entitled to receive interest at the rate of eight per cent. per annum, payable quarter-yearly on the first days of September, December, March and June in each year, from and out of the profits of the company before any dividend can be declared or paid on the stock or share capital; but no payment of interest can or shall be made on such debenture stock which will impair the capital, nor unless the amount paid shall have been actually earned by the company. In event of default in payment of the interest on the debenture stock represented by this certificate, the unpaid interest shall become and remain an obligation of the company, payable out of any future profits to the full extent of such unpaid interest before any dividend can be declared or paid on the stock or share capital. In the event of the dissolution or winding up of the company, the holders of debenture stock shall rank *pari passu* with other unsecured creditors of the corporation."

At the time of the organization of the company, the appellants, constituting the firm of Cresswell & Washburn, were manufacturers and dealers in wall paper, under the firm name of Cresswell & Washburn. Other firms and individuals were engaged in like business in various parts of the country. These various concerns commenced negotiations with the National Wall-Paper Company, which resulted in the acquisition by the latter of the property and assets of the several concerns, including complainants' firm of

Cresswell & Washburn. All these acquisitions took place under separate contracts in substantially the same form which contained these provisions: (1) "The value of the fixed plant, machinery, fixtures, chattels, merchandise, book accounts, and other assets hereby transferred, shall be fixed by \* \* \* the appraisers." (2) "There shall be issued to the vendors, in payment for the property and assets acquired hereunder, the obligation of the company in the nature of one or more certificates of indebtedness, to be known as 'debenture stock,' in an amount equal to the appraised value of the property and assets hereby transferred, such appraised value to be fixed in the manner hereinbefore provided," etc. (3) "There shall be further issued and paid to the vendors for the good-will of the business thereby transferred, and in consideration of the execution by them of this agreement, and of the further contracts assuring the continued good-will of such business to the company \* \* \* an amount of common stock equal at par to sixteen times the net earnings of the vendors in their business, for the eleven months commencing July 1, 1891, and ending May 31, 1892, less the appraised value of the property to be transferred to the company; but the issue of such common stock shall be subject to the conditions and restrictions hereinafter contained, viz. (that vendors should deposit their stock in a voting trust)." (4) "For the purpose of fixing the amount of the common stock of the company to which the vendors shall be entitled \* \* \* as payment for the good-will of the business so to be transferred, and for the assurance of such good-will to the company," the agreement provided for an ascertainment of profits for the eleven months from July 1, 1891. (5) The vendors guaranteed the collection of the accounts and bills receivable transferred by them. In case of any failure of collection, the vendors were to surrender back to the company debenture stock equal at par to the face value of the uncollectible amount, "and also an amount of stock equal at par to sixteen times the face value of such uncollected book accounts and bills receivable, less the amount of debenture stock returned." The vendors further covenanted with the company that they would, neither directly nor indirectly, engage in the business of manufacturing, buying or selling wall paper. If they did, they were to forfeit to the company all the stock issued to them. In valuing good-will, patents, copyrights and trade-marks were to be regarded as part of the good-will. These, however, were relatively insignificant. There is criticism, supported by testimony, of the manner in which the profits of the respective concerns for the specified eleven months were ascertained, but it is not necessary to set forth the details; the figuring was all done by the same accountants, and the methods were alike in all the cases.

The stock corporation law (laws 1892, ch. 688), § 42, provides: "No corporation shall issue either stock or bonds except for money, labor done, or property actually received for the use and lawful purposes of such corporation. No such stock shall be issued for less than its par value; no such bonds shall be issued for less than the fair market value thereof." It will be perceived from the foregoing statement that the stock of the defendant company was issued for the "good-will" of the different manufacturing plants (and some patents, trade-marks, etc.), the tangible assets of which plants, viz., machinery, fixtures, material, book accounts, etc., were paid for by the issue of the debenture stock. Practically the entire capital stock (i. e., the common stock) is represented by the good-will of the establishments which the defendant company bought up. Complainants received for their old plant, book accounts, good-will, etc., \$326,000 in debenture stock, and \$1,831,800 in common stock, of which, by the reason of uncollectibility of certain accounts, they subsequently returned \$7,702.19 of debenture stock and \$135,200 of common stock. When the suit was begun, the accountants, designated under the by-laws as auditors, had made no certificate of net earnings. Subsequently, and on April 22, 1896, they certified that they had examined the books and accounts from the date of inception to February 29, 1896, and found the net profits for the entire period to be \$3,046,639.66. They further certified that "the surplus profits remaining on hand on said 29th day of February, 1896, representing the net earnings of the company available for the payment of

interest on its debenture stock, over and above the sums already expended for interest, amount to \$1,410,522.39." This sum so certified is \$866,528.29 in excess of the debenture interest unpaid and claimed to be accrued on February 29, 1896; *i. e.*, for 11 months at 8 per cent. per annum, viz., \$543,994.

LACOMBE, CIRCUIT JUDGE (after stating the facts). The contention of the complainants is that, notwithstanding the certificate of the auditors, no debenture interest could be paid without impairing the capital of the company, and that in fact there were no profits. They contend that they have demonstrated the impairment of the capital stock to an extent more than sufficient to prevent the payment of debenture interest; first, on the theory that the capital stock was originally issued for far less than its par value, and has never been fully, if at all, paid; second, on the theory that, even if it were originally fully paid, there has been an enormous depreciation in the value of the capital stock since that time; third, by losses and depreciations in assets other than the good-will for which the capital stock was originally issued.

The first of these propositions suggests the questions whether stock is issued for "property actually received," within the meaning of the statute, when it is issued for good-will only; and whether, assuming that the entire stock could, under the New York act of 1892, be issued solely for good-will, the good-will taken in this case was taken at its actual value. These questions are discussed at great length in the briefs. It is contended that, although "good-will" is property in the sense that it is a subject of bargain and sale, it is nevertheless but a so-called "parasitical species of property, which can not exist apart from the substantial property of which it is an attribute;" that it is not a thing of value by itself; that the capital of a corporation must be invested in property capable of existence by itself; that in this case no effort was made to ascertain the actual value of the good-will; that the value at which it was appraised and stock issued against it was purely arbitrary, and in no sense a proper valuation, and that in determining this arbitrary valuation elements of alleged profits were taken into consideration which could not fairly be considered such. Upon this interesting, and possibly perplexing, discussion we do not find it necessary to embark. Good-will has been defined as "all that good disposition which customers entertain towards the house of business identified by the particular name or firm, and which may induce them to continue giving their custom to it." There is nothing marvelous or mysterious about it. When an individual or a firm or a corporation has gone on for an unbroken series of years conducting a particular business, and has been so scrupulous in fulfilling every obligation, so careful in maintaining the standard of the goods dealt in, so absolutely honest and fair in all business dealings that customers of the concern have become convinced that their experience in the future will be as satisfactory as it has been in the past, while such customers' good report of their own experience tends continually to bring new customers to the same concern, there has been produced an element of value quite as important—in some cases, perhaps, far more important—

than the plant or machinery with which the business is carried on. That it is property is abundantly settled by authority, and, indeed, is not disputed. That in some cases it may be very valuable property is manifest. The individual who has created it by years of hard work and fair business dealing usually experiences no difficulty in finding men willing to pay him for it, if he be willing to sell it to them. Legislation devised to restrict the accumulation of the fruits of industry may impair its value by denying to its producer the right to enter into a contract enforceable at law not to interfere with its enjoyment by the purchaser, but, so long as any belief in human honesty remains, there will be found some persons willing to buy such property, the very existence of which implies honest business dealing in the past. And so long as it remains salable it is valuable. Nor is it indissolubly connected with any particular locality, or any specific tangible property. Reference has been made on the briefs to the publishing house of "Harper & Bros." If its present establishment in Franklin Square were destroyed by fire to-morrow, and everything therein contained were swept out of existence, it is surely manifest that, so long as the firm itself survived, and continued to transact its old business, it would still hold its "good-will," although the business should be thenceforward conducted in a new building erected on some up-town street, and supplied with entirely new machinery and equipments. If good-will be a "parasite," it is a "parasite" of the business from which it sprung, not of the mere machinery by which that business was conducted.

Since good-will is property, and since in some cases it is a valuable property, it would follow that in some way or other it must be practically possible to determine what that value is. Whether the particular method employed in the case at bar to ascertain such value is or is not a proper one, and whether the appraisal made when these several wall paper concerns were bought up by the defendant company was accurate, we are under no obligation to inquire upon the complainants' request. The method of valuation was one which they fully approved, and which was applied in fixing the value of their own property, as a result of which they received \$1,831,800 in common stock of the defendant. They certainly, participating in the transaction, and reaping its benefits, are in no position now to claim that the good-will bought by the defendant company with common stock was overvalued. \* - \* \*

Complainants further contend that on February 29, 1896, there were not profits sufficient to warrant the payment of interest on the debenture stock, such interest concededly being payable only out of profits. This interest, it will be remembered, amounted to \$543,994, and the auditors certified that the profits on that day aggregated \$1,410,522.39. It is insisted that certain items of assets were taken by the auditors at an excessive valuation, that in some cases items not properly assets were included on the credit side of the account, and that sufficient sums were not deducted for depreciation, reserves, etc. These items are:



Birge good-will.....	\$2,100,000 00
Birge bonus.....	300,000 00
Addition to Block account.....	100,000 00
Selling expenses treated as an asset.....	166,050 17
Reserve for depreciation.....	300,000 00
Reserve for bad debts of business of 1892 to 1894.....	50,000 00
Reserve for bad debts of business of 1894 to 1896.....	150,000 00
Eight per cent. for valuation of manufactured goods.....	60,000 00
	<hr/>
	\$3,226,050 17

The first two items may be considered together. About the time when complainants sold their business to the defendant company, in 1892, some effort seems to have been made to buy up the establishment and business of the firm of M. H. Birge & Sons, of Buffalo, upon the same terms as all the others, but Birge & Sons refused to entertain the offer. Subsequently, in December, 1894, a fire destroyed part of the Birge plant at Buffalo. Thereupon, defendant company, apparently with a view of ingratiating itself with the firm, offered to lease it one of the defendant's factories, which was temporarily shut down. Negotiations for the purchase of the entire Birge business and outfit were subsequently begun, and finally Birge made an offer to sell at a certain price, leaving his offer open for but a brief period. It was accepted, although not without disapproval by a minority of the board of directors, including complainant Washburn. The price agreed upon was \$300,000 in cash on the day of signing the contract, \$2,100,000 in common stock, \$50,000 in debenture stock, and an additional sum in cash, to be paid when appraisement of the tangible assets was completed, and which turned out to be \$129,286.36. The auditors treated this transaction as a purchase of assets for permanent investment, and \$2,400,000 of it as paid for good-will and patents. This is a strictly accurate statement of the transaction, and the only possible objection to the auditors' figuring is the suggestion that the good-will and patents were not worth \$2,400,000, either when bought, in February, 1895, or when counted as an asset, in February, 1896. Here, again, the question is presented, What is the actual value of this property? But the record gives us no information upon which to answer.

It is urged on behalf of defendants that Birge & Sons were a well-known house, which had been in existence for over forty years, and were most favorably known throughout the entire western part of the state of New York; that their annual business largely exceeded \$1,000,000; that the profits for the three years preceding the purchase (including the disastrous years of 1893 and 1894) amounted to from \$175,000 to \$225,000 a year; that they were the owners of a number of patents of great utility in the manufacture of wall paper, and 147 design patents; that Mr. Birge, the head of the house, was a man in the prime of life, active, energetic, of high business capacity, with a thorough understanding of the wall paper business, and one of the strongest and most dangerous competitors of the defendant company. The president of defendant company testified that he considered the



property well worth what was paid for it; that it was an extremely valuable business, and that he still considered it one of the best purchases the company ever made. On the other hand, the complainant Washburn expressed the opinion that the price paid for it was extravagant, although he would have been willing to buy it on the same terms as the other plants, and that the patents were not of much, if any, value. This is practically all the testimony we have from which to determine at what figures the auditors should have set down the property represented by the Birge patents and good-will. Evidently the majority of the board of directors supposed it was worth the price paid, or they would not have paid it. It would seem to require affirmative evidence to discredit their conclusions. It is suggested in the brief that "\$2,100,000 is a large amount of money." So, too, is \$1,800,000, and it is quite apparent from this record that the long-established and well-known concern engaged in this business represents much more value than is to be found in its real estate, factory outfit, goods and credits. Certainly it was something of value which enabled complainants in the face of active competition to make a net profit of over \$110,000 in eleven months out of a plant worth considerably less than \$320,000. Reference is made to the statement of the president on direct examination that the price paid for the Birge property was reached "arbitrarily." It is evident from the rest of his testimony, however, that what he meant was that the rule used in other cases, viz., the difference between tangible assets and sixteen times the net profits, was not applied. Upon the testimony, as it stands, we can not find that the auditors erred in treating the Birge good-will and patents as an asset worth what the company paid for it. \* \* \*

*Affirmed.*

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**Sec. 681. Same.**

MR. JUSTICE BROWN IN CAMDEN V. STUART.

1892. IN THE SUPREME COURT OF THE UNITED STATES. 144 U. S. Rep. 104, on 109, 110 and 115.

"The single question involved in these appeals is whether the defendants, Stuart and Camden, can be called upon to pay in their proportions of unpaid subscriptions to the capital stock of the White Sulphur Springs Company.

"The capital stock of this company was fixed at \$150,000, and the certificate of incorporation of December 3, 1880, stated that \$50,000 had been 'paid in on said subscriptions.' \* \* \*

"The experience and good-will of the partners, which it is claimed were transferred to the corporation, are of too unsubstantial and shadowy a nature to be capable of pecuniary estimation in this connection. It is not denied that the good-will of a business may be the subject of barter and sale as between the parties to it, but in a case of this kind there is no proper basis for ascertaining its value, and the claim is evidently an afterthought."

**Sec. 682. Same.** (b) Valuation of property: True value rule. Notice.

**STATE TRUST COMPANY v. TURNER.<sup>1</sup>**

1900. IN THE SUPREME COURT OF IOWA. 111 Iowa Rep. 664, 82 N. W. Rep. 1029, 53 L. R. A. 136.

[The Hess Electric Storage-Battery Company was organized in Iowa in 1890, to perfect a storage-system patented by Hess, adapt it to practical use, buy and sell the patent, obtain others, and to buy and sell electric light plants, electric batteries, currents, etc. The capital stock was fixed at \$100,000, 1,000 shares of \$100 each, of which \$90,000 might be issued as fully paid for the purchase of the patents and property. The articles were signed by Porter, Hess, Case and others, Case being vice-president and a director. After articles were filed, Porter, Hess and Case proposed to sell the patents owned by them to the company for \$90,000 fully paid-up stock and \$500 cash as soon as the corporation could pay. The board of directors accepted this proposition, and the conveyance of the patents and property was made and the stock delivered. On the day before the proposition was made, and other days near that time, thirty shares of fully paid stock were issued to Turner, for which nothing was paid to the corporation, but which all treated as part of the \$90,000 to be issued to Porter and his associates, and for which Turner paid 20 cents on the dollar in cash to Porter and his associates, or their assignees. The remainder of the \$90,000 was issued in blocks of five and ten shares to nine other persons, all of whom had signed the articles of incorporation, and to Porter et al., and their assignees. An agreed statement of facts set forth that the chemicals, property, etc., were worth \$500 at the time of the purchase, and that the patents had not been largely put in use, but many experiments had been made showing satisfactory results, all of which were known to the company, and led the incorporators to hope and believe they were of great value, and the company would realize much more than \$90,000 for them; that after incorporation, tests and experiments were continued until 1894; many offers for purchase of territory had been received but rejected, because they were believed to be too small; that in the meantime other inventions had been made by other parties, whereby the company had not been able to realize revenues from its own patents to the extent anticipated, or sufficient to meet its expenses. In 1893 it borrowed \$670 from a loan association, giving its note therefor due in one month. This association had full knowledge of the details of organization of the company, the method of payment of the stock, and the value of the patents. After the maturity of the note, it was transferred to the plaintiff, who obtained judgment, and after execution returned "no property found," brought this suit; the court below gave judgment for the defendant, and plaintiff appeals.]

<sup>1</sup> Statement abridged. Part of opinion omitted.

DEEMER, J. \* \* \* Involved primarily is the so-called "trust-fund doctrine," as applied to stockholders' obligations to creditors. This is founded on the proposition that as the state undertakes to relieve the stockholder in a corporation of general liability for the debts of the concern to the amount that he has invested in the enterprise, he ought, in good faith, to pay in money or its equivalent the face value of the stock received; and, if he fails to do this, he should be treated as holding the remainder in trust for the benefit of the creditors of the corporation. From this proposition two apparently conflicting and inconsistent rules have grown up, one of which may be called the "true-value rule," and the other the "good-faith rule." Courts adopting the good-faith rule are also divided on the proposition as to what is necessary to be shown to constitute good faith. Some of them hold that, in the absence of an affirmative showing of fraud aliunde, mere overvaluation of the property given in exchange for stock will not render the stockholder liable for the difference, while others hold that overvaluation itself, especially if gross, constitutes, or at least raises a strong presumption of fraud. The development of the trust-fund doctrine may be gathered from a reading of the following: *Wood v. Dummer*, 3 Mason 308, Fed. Cas. No. 17944; *Sawyer v. Hoag*, 17 Wall. 610, 21 L. Ed. 731; *Handley v. Stutz*, 139 U. S. 417, 11 Sup. Ct. 530, 35 L. Ed. 227, and cases cited therein; *Hollins v. Iron Co.*, 150 U. S. 371, 14 Sup. Ct. 127, 37 L. Ed. 1113; *Osgood v. King*, 42 Iowa 478. *Cases holding to the true-value doctrine* are as follows: *Van Cleve v. Berkey*, 143 Mo. 109, 44 S. W. Rep. 743, 42 L. R. A. 593; *Joseph v. Davis* (Ala.), 10 South. 830; *Gates v. Stone Co.*, 57 Ohio St. 60, 48 N. E. Rep. 285; *Haldeman v. Ainslie*, 82 Ky. 395; *Libby v. Tobey*, 82 Me. 397, 19 Atl. 904; *Elyton Land Co. v. Birmingham Warehouse & Elevator Co.*, 92 Ala. 407, 9 South. 129, 12 L. R. A. 307; *Clayton v. Knob Co.*, 109 N. C. 385, 14 S. E. Rep. 36; *Gogebic Inv. Co. v. Iron Chief Min. Co.*, 78 Wis. 427, 47 N. W. Rep. 726. *Some of those holding to the first division of the good-faith rule* are *Smith v. Prior*, 58 Minn. 247, 59 N. W. Rep. 1016; *Schenck v. Andrews*, 57 N. Y. 133; *Van Cott v. Van Brunt*, 82 N. Y. 535; *Graves v. Brooks*, 117 Mich. 424, 75 N. W. Rep. 932; *Coit v. Amalgamating Co.*, 119 U. S. 343, 7 Sup. Ct. 231, 30 L. Ed. 420; *Kelley v. Fletcher*, 94 Tenn. 1, 28 S. W. Rep. 1099; *Rickerson Roller-Mill Co. v. Farrell Foundry & Machine Co.*, 43 U. S. App. 452, 23 C. C. A. 302, 75 Fed. 554; *Phelan v. Hazard*, 5 Dill. 45, Fed. Cas. No. 11068; *New Haven Horse-Nail Co. v. Linden Springs Co.*, 142 Mass. 349, 7 N. E. Rep. 773. *And of those holding to the second division* are *Douglass v. Ireland*, 73 N. Y. 100, 104; *Boynton v. Andrews*, 63 N. Y. 93, 96; *Hastings Malting Co. v. Iron Range Brewing Co.*, 65 Minn. 28, 67 N. W. Rep. 652; *Kelly v. Mining Co.*, 21 Mont. 291, 53 Pac. Rep. 959, 42 L. R. A. 621; *Lloyd v. Preston*, 146 U. S. 630, 13 Sup. Ct. 131, 36 L. Ed. 1111; *Wallace v. Manufacturing Co.*, 70 Minn. 321, 73 N. W. Rep. 189. It will be noticed that there is some confusion in the New York and United States Supreme Court cases, and it is difficult

to say just what rule prevails in Illinois. See *Sprague v. Bank*, 172 Ill. 149, 50 N. E. Rep. 19, 42 L. R. A. 606. But the supreme court of the United States has never departed from the principles of *Sawyer v. Hoag*, and other like cases. See *Camden v. Stuart*, 144 U. S. 104, 12 Sup. Ct. 585, 36 L. Ed. 363. Nothing further need be said regarding the attitude of the various courts of the country on these propositions. Some of the cases cited may not clearly fall to the places assigned them, but, on the whole, we think this as fair a classification of the authorities as can be made. In view of our previous holdings, this discussion may seem unnecessary, but, as counsel seem to think that the question is new to this court, we have attempted to state in brief some of the holdings in other jurisdictions.

We think our previous cases adopt the true-value rule—perhaps not to its full extent; but such has been the drift of these cases. In *Osgood v. King*, 42 Iowa 478, we said: “Every principle of honesty and justice demands that, as between the stockholder and the creditor, the stock shall be considered paid only to the extent of the fair value of the property conveyed, and that for the balance the stockholder shall be held individually liable.” In *Jackson v. Traer*, 64 Iowa 477, 20 N. W. Rep. 767, quoting from *Taylor on Corporations*, we said: “If the property secured is grossly unequal in value to the par value of the shares, the subscriber who secured the shares originally, or his subsequent transferee with notice of the circumstances, may be compelled to make up the difference in value.” In *Chisholm v. Forny*, 65 Iowa 333, 21 N. W. Rep. 664, Seevers, J., speaking for the court, said: “Persons dealing with the corporation had the right to assume that it owned valuable assets to the amount of its capital stock; that is to say, that, in consideration for the stock issued, the corporation had received money or property which would be available to pay an indebtedness incurred in its business. A patent is, as has been said, a property in a notion, and has no corporal, tangible substance, and can not be levied on and sold under execution issuing from state courts; and whether it can be sold on executions issuing from the federal courts is regarded as doubtful. Until its usefulness has been established, the value of a patent right is purely speculative.” Judge Robinson, in *Wishard v. Hansen*, 99 Iowa 307, 68 N. W. Rep. 691, uses this language: “Where the capital stock of a corporation is issued to one of its promoters and organizers for property which is taken at a gross overvaluation, the transaction is fraudulent against creditors of the corporation, if it be insolvent; and the stockholder who receives such stock with knowledge \* \* \* will be liable to creditors, on the stock he holds, for the difference between the par value \* \* \* and the amount actually paid.”

In *Stout v. Hubbell*, 104 Iowa 499, 73 N. W. Rep. 1060, it is said: “It is alleged \* \* \* that the land was given and received under an agreement that it was a full payment for the stock. This, alone, would, be no defense; for this court has held, as to creditors of a corporation, that, when property is received by the corporation at an excessive valuation in payment for shares of its capital stock, it is

only a payment to the extent of the value of the property received, and the owner of such stock is liable to creditors for the difference between the actual value of the property and the face value of the stock." In *Carbon Co. v. Mills*, 78 Iowa 465, 43 N. W. Rep. 290, 5 L. R. A. 649, we again quoted with approval the rule announced by Mr. Taylor in his work on Corporations, and said that no plea of fraud was necessary. From this review it is apparent that we have, in effect, adopted the true-value rule, although saying in some cases that the reason for so doing was to prevent fraud. There is nothing in these decisions or in the statutes that inhibits the taking of property in exchange for stock, providing it is taken at its true value; and this value we do not think should in all instances, if in any, be measured by results. The parties have the right in good faith to agree on the value of the property taken, but this should not be a speculative or fictitious one. An honest mistake in judgment will not necessarily destroy the value agreed upon, but it must be such a valuation as prudent and sensible business men would approve. Values based on visionary or speculative hopes, unwarranted by existing conditions or facts, and without reasonable evidence from present appearances, are not such as the law will tolerate, as against creditors. It is apparent that the patent and property sold the corporation by Porter et al. had no such value as the parties placed upon it. The valuation was wholly speculative, visionary, and imaginary, as experience has shown. Indeed, we doubt if the parties thought it had any such value as they fixed upon it. They say they hoped and believed the company would realize therefor and thereon more than \$90,000, but no one had the temerity to say that he regarded the patent and property as of that value. The actual value received was but little over \$500.

But it is said that, as plaintiff's assignor had full knowledge and notice of all the facts, plaintiff can not recover. This contention requires a little further examination of the rationale of the trust-fund doctrine. Consideration of the cases will show that it grew out of a desire on the part of courts to protect creditors who invested their funds on the faith that the capital stock was fully paid up and represented the true assets of the corporation. \* \* \*

(Citing and quoting from *Sawyer v. Hoag*, 17 Wall. 610; *Upton v. Tribilcock*, 91 U. S. 45; *Scovill v. Thayer*, 105 U. S. 143; *Hollins v. Brierfield, etc., Co.*, 150 U. S. 371, and *Fogg v. Blair*, 133 U. S. 534.)

Following this doctrine to its logical conclusion, it was held in *Bank v. Alden*, 129 U. S. 372, 9 Sup. Ct. 332, 32 L. Ed. 725, that where the creditor has full knowledge of the transaction between the corporation and its stockholder at the time he extends credit, he can not be heard to complain, for the reason that no credit is given upon a representation of a different set of facts than those which actually existed. See, also, *Coit v. Amalgamating Co.*, 119 U. S. 343, 7 Sup. Ct. 231, 30 L. Ed. 420; *Walburn v. Chenault* 43 Kan. 352, 23 Pac. Rep. 657; *Whitehill v. Jacobs*, 75 Wis. 474, 44 N. W. Rep. 630; *Young v. Iron Co.*, 65 Mich. 111, 31 N. W. Rep. 814; *Woolfolk v.*

January, 131 Mo. 620, 33 S. W. Rep. 432; Manufacturing Company v. Wallace, 16 Wash. 614, 48 Pac. Rep. 415; Robinson v. Bidwell, 22 Cal. 379; First Nat'l Bank of Deadwood v. Gustin Minerva Con. Min. Co., 42 Minn. 327, 44 N. W. Rep. 198, 6 L. R. A. 676. Indeed, we find no case to the contrary, unless it be Sprague v. Bank, 172 Ill. 149, 50 N. E. Rep. 19, 42 L. R. A. 606. That decision was based on a statute, however, which is somewhat different from ours. \* \* \*

As the Commercial Loan Association had full knowledge of all the facts relating to the issuance and payment for the stock owned by the defendant, it could not recover. Does plaintiff, its transferee after maturity, have any greater right? We think not. \* \* \*

Our conclusion is that the judgment of the trial court should be, and it is, affirmed.

*Note.* 1. As to the right to issue stock for property, see, 1883, Liebke v. Knapp, 79 Mo. 22; 1886, Coit v. Gold Amal. Co., 119 U. S. 343. *Contra*: 1848, Henry v. Vermillion & A. R., 17 Ohio 187.

2. True-value rule: 1840, Society for Illus. Prac. Kn. v. Abbott, 2 Beav. 559; 1896, Wishard v. Hansen, 99 Iowa 307, 61 Am. St. Rep. 238; 1897, Gates v. Tippecanoe Stone Co., 57 Ohio St. 60, 63 Am. St. Rep. 705; 1898, Kelly v. Clark, 21 Mont. 291, 69 Am. St. Rep. 668; 1898, Van Cleve v. Berkey, 143 Mo. 109, 42 L. R. A. 593, *infra*, p. 1953; 1899, Jenkins v. Bradley, 104 Wis. 540, 80 N. W. Rep. 1025; 1900, Steam Stone Cutter Co. v. Scott, 157 Mo. 520, 57 S. W. Rep. 1076. *supra*, p. 1917; 1902, Berry v. Ross, — Mo. —, 67 S. W. 644.

Compare with Graves v. Brooks, 117 Mich. 424, *infra*, p. 1950, and note.

### Sec. 683. Same. Notice of value from articles of association.

F. D. STOUT AND M. E. McHENRY, APPELLANTS, v. F. M. HUBBELL.<sup>1</sup>

1898. IN THE SUPREME COURT OF IOWA. 104 Iowa Rep. 499-505.

[Plaintiffs were judgment creditors for over \$6,000 against the Des Moines Driving Park, an insolvent corporation, and sue here to charge defendant as owner of 548 shares of unpaid stock in the corporation, of the face value of \$54,800, for which it is alleged the corporation received only ninety-one acres of land worth \$8,000, leaving over \$46,000 yet due. The defendant answered that the projectors of the corporation agreed before organization to convey their lands at \$600 per acre in the stock of the company, and that this was carried out, and that the same was fully set forth in the articles of incorporation, which were duly filed, recorded and notices published as required by law, and that this operated as notice to the plaintiffs. The articles of incorporation set forth the capital stock, and showed that the directors were required to purchase these lands (specifically describing them) and pay for them by issuing \$64,437 in stock at par, of which defendant was to receive \$54,800, and that the stock as issued should be held and regarded as fully paid up. The public notice of incorpora-

<sup>1</sup> Statement abridged, and part of opinion omitted.



tion showed the amount of stock, and stated that fully paid-up and non-assessable shares to the amount of \$64,437 should be issued to pay for the real estate purchased by the corporation.]

GIVEN, J. \* \* \* Defendant's counsel do not contend that an agreement by which the stock was received as fully paid up, in consideration of land at an excessive valuation, would alone constitute a defense. They concede that it is a fraud upon creditors for the corporation to agree to accept either less than par value in money, or property worth less than par. Their contention is that "it is impossible, however, that such an agreement upon the part of the corporation should be a fraud upon a creditor whose debt is created with full knowledge of the manner in which, as between the corporation and the stockholder, the stock has been fully paid." Relying upon the rule that those dealing with the corporation must be held to have knowledge of the provisions of its articles of incorporation, they insist that the further allegation of said second count, as to the contents and recording of the articles of incorporation, and publication of the notice of incorporation, show actual or constructive notice to the plaintiffs of the terms upon which this stock was issued, and that, having extended credit with that knowledge, they are not entitled to recover. Let it be conceded that the plaintiffs are chargeable with all the knowledge which the record of the articles of incorporation imparted. It remains to inquire what that knowledge is. That record told that the directors were authorized and required to purchase of the defendant his said tract of land, and to pay therefor by issuing to him "stock at par for the said sum of fifty-four thousand eight hundred dollars. \* \* \* Said stock, when so issued, to be held and regarded as fully paid for by the conveyance of the real estate described to this association." A person examining these articles with a view to determining whether or not to extend credit to the corporation, would know therefrom that the corporation had given, as fully paid-up, fifty-four thousand eight hundred dollars of its capital stock in payment for these ninety-one acres of land. He would have a right to presume that the transaction was fair and free from fraud, and therefore to understand that the land was substantially equal in value to the par value of the stock. There is nothing in this record to indicate otherwise, and these plaintiffs, in extending credit to the corporation, had a right to assume from this record that, instead of said stock, the corporation had ninety-one acres of land of the value of fifty-four thousand eight hundred dollars. The fraud upon creditors in this transaction is not in the fact that land was taken in payment for stock, but that, according to these pleadings, land was taken at an excessive valuation of forty-six thousand eight hundred dollars,—a fact of which these articles imparted no information. Charging these plaintiffs with all knowledge which the record of the articles imparted, it is clear that that record did not impart the very information that was necessary to a knowledge of the fraud. Therefore, they dealt with the corporation without knowledge that the land had been taken at an excessive valuation. It is said that no fraud is alleged,

but facts are alleged which constitute a fraud as to the creditors. In *Carbon Co. v. Mills*, 78 Iowa 460, fraud was not pleaded in the petition, and this court said, "But, under the facts of the case, this was not necessary." \* \* \*

*Demurrer should have been sustained. Reversed.*

*Note.* See note preceding case.

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**Sec. 684.** Same. Statute,—notice of value.

MR. JUSTICE BOGGS IN *SPRAGUE v. NATIONAL BANK OF AMERICA*.

1898. IN THE SUPREME COURT OF ILLINOIS. 172 Ill. Rep. 149, on 165, 168, 169, 64 Am. St. Rep. 617, 42 L. R. A. 606.

The Revised Statutes of Illinois, section 8, chapter 32, provide that "each stockholder shall be liable for the debts of the corporation to the extent of the amount that may be unpaid upon the stock held by him." \* \* \*

Counsel for the appellants cite adjudicated cases wherein it has been held that where subscription to the capital stock of a corporation was paid in property, which was received by the corporation as in full payment of the subscription to its capital stock, such payment is, so far as the corporation is concerned, payment in full, and the corporation can enforce no further demand against the stockholder, and that a creditor of the corporation stands in no different position from the corporation, unless a fraud was committed on him by the arrangement between the corporation and the stockholder which operated to deprive him of some security upon which he had relied when he extended credit to the corporation; and also an expansion of the same doctrine, that if the creditor knew, when he gave credit to the corporation, the stock had been issued as full paid in payment for property purchased by the corporation, or had means of acquiring such knowledge, the creditor would stand in no better position than the corporation, and could only enforce liability against the stockholder in case the corporation could recover from such stockholder. We think the doctrine of these cases has no application as against the express declaration of our statute that the creditor shall be invested with a right to recover if the stock had not been fully paid. The legislative intent was that any amount unpaid upon subscription to the capital stock of a corporation should constitute a fund to which a creditor of the corporation might resort to obtain satisfaction of his demand against the corporation. We hold, therefore, that under our statute the right of a creditor to enforce liability against one who has subscribed for stock in a corporation and has not paid his subscription in full is not dependent, in any degree, upon the knowledge possessed by the creditor that such subscription was or was not paid in full. If unpaid to the corporation it must be paid to the creditor. \* \* \*

*Note.* See note to *State Trust Co. v. Turner*, *supra*, p. 1947.

**Sec. 685. Same. (c) Actual fraud rule.**

GRAVES v. BROOKS.

1898. IN THE SUPREME COURT OF MICHIGAN. 117 Mich. Rep. 424-426.

Bill by Henry B. Graves, receiver of the Latimer Cash-Register Company, against Alanson S. Brooks, William G. Latimer, and Frederick W. Towle, impleaded with the corporation and other stockholders therein, to compel an assessment for the payment of debts. From a decree for complainant, defendants appeal. Reversed.

The bill of complaint was filed by the receiver of the Latimer Cash-Register Company, a corporation, to compel an assessment upon its stockholders to pay its debts. The capital stock of the corporation was \$200,000; \$100,000 was issued to the defendants, Latimer, Brooks, and Towle, who were the owners of the patents conveyed to the corporation, as fully paid, in consideration for the transfer of such patents to it. The other \$100,000 of the stock was assessable. The corporation became insolvent, and after the sale of all its tangible assets, and the application thereof to the payment of its debts, a considerable amount remained unpaid. The case was heard upon pleadings and proofs, and the court below found that the property conveyed by the patentee stockholders was worth \$20,000, and that the cash-paying stockholders had paid in \$20,000, and directed an assessment upon all the capital stock, except certain shares of the non-assessable stock which had been sold and transferred by the patentee stockholders to other parties, who were held to be innocent, good-faith purchasers. From this decree defendants Latimer, Brooks and Towle alone appealed.

GRANT, C. J. The stockholders of the defendant corporation were lawyers and business men. Before organizing the corporation and making the agreement with the patentee stockholders, a careful investigation was made by them into the merits and value of the patents. A model of the register was submitted. Two firms of attorneys specially skilled in patent law, and acting independently of each other, had given opinions sustaining the validity of the patents. These opinions were submitted to the stockholders. Careful estimates were made of the cost of constructing the machines. The conclusion was reached that \$20,000 would suffice to construct the necessary machinery and place the registers upon the market. The appellant defendants sold some of their non-assessable stock, and purchased some that was assessable. There is no claim of fraud, bad faith, misrepresentation or recklessness on the part of the owners of the patents. They submitted to these capitalists all the knowledge they possessed. For aught that appears upon this record, the cash stockholders were as competent to judge of the probable success of the enterprise and the value of the patents as were the others. For reasons unnecessary to state, the stockholders, after an expenditure of about \$20,000, de-

cided to abandon the enterprise and wind up the affairs of the corporation.

The learned circuit judge evidently based his conclusion, not upon any fraud, but upon the finding that the patents conveyed were in fact worth only \$20,000, instead of \$100,000, the agreed purchase-price. It is unnecessary to enter into a discussion of the question. The case, in all its essential features, is similar to *Young v. Erie Iron Co.*, 65 Mich. 111, where the subject is fully discussed in an opinion by Mr. Justice Morse, concurred in by the entire court. It was there held that, in order to render stock, issued as fully paid and non-assessable, assessable, it is necessary to establish either an intentional fraud in fact, or such reckless conduct in fixing the value of the property conveyed, without regard to its actual value, that an intent to defraud may be inferred. The creditors in that case were remediless. No case of fraud or recklessness having been established, it follows that the contract of the parties must control.

The decree must be reversed, with the costs of both courts, and the case remanded to the court below, with directions to enter a decree against the assessable stock sufficient to pay the debts of the corporation.

The other justices concurred.

*Note. Accord:* 1873, *In re H. & M. Tin Co., Spargo's Case*, L. R. 8 Ch. App. 407; 1886, *Coit v. Gold Amal. Co.*, 119 U. S. 343; 1894, *Kelly v. Fletcher*, 94 Tenn. 1, 28 S. W. Rep. 1099; 1898, *Penfield v. Dawson Town & G. Co.*, 57 Neb. 231, 77 N. W. Rep. 672; 1899, *Gillin v. Sawyer*, 93 Maine 151, 44 Atl. Rep. 677.

It is held, also, by one line of decisions, that a great difference between the value of the property taken and the face value of the stock is *prima facie* evidence of fraud, and if not explained is sufficient evidence thereof: 1891, *Elyton Land Co. v. Elevator Co.*, 92 Ala. 407, 25 Am. St. Rep. 65 (\$55,000 property for \$250,000 stock); 1895, *Coleman v. Howe*, 154 Ill. 458, 45 Am. St. Rep. 133 (\$75,000 property for \$300,000 stock); 1896, *Hastings Malting Co. v. Iron R. B. Co.*, 65 Minn. 28 (\$18,000 property for \$30,000 stock); 1896, *Wishard v. Hansen*, 99 Iowa 307, 61 Am. St. Rep. 238 (about \$45,000 property for \$120,000 stock); 1898, *National Bank of Merrill v. Illinois & W. L. Co.*, 101 Wis. 247, 77 N. W. Rep. 185 (\$20,000 property for \$60,000 stock); 1898, *Lea v. Iron Belt Mercantile Co.*, 119 Ala. 271, 24 So. Rep. 28 (\$100,000 property for \$1,250,000 stock).

See, also, *State Trust Co. v. Turner*, 111 Iowa 664, 82 N. W. Rep. 1029, *supra*, p. 1943, and note.

## Sec. 686. 7. Fictitious issue of stock. (a) Meaning of term.

MYRICK, J., IN *STEIN v. HOWARD*.

1884. IN THE SUPREME COURT OF CALIFORNIA. 65 Cal. Rep. 616, on 617, 618.

[Suit by shareholders to enjoin the Spring Valley Water-Works from doubling its stock and issuing the increase as full paid shares, upon payment of its market value, \$87.50 per share, for purpose of

raising funds to increase its capacity and extend its works. Appeal from order denying injunction.]

The civil code of this state, section 359, makes provision for an increase of the capital stock of an incorporation. The constitution of this state contains the following prohibition in article 12, section 2: "No corporation shall issue stock or bonds except for money paid, labor done or property actually received, and all fictitious increase of stock or indebtedness shall be void." The question for decision on this appeal is, whether the stock proposed to be issued and sold will create a fictitious increase of stock. Webster's dictionary defines the word "fictitious" to mean feigned, imaginary, not real, counterfeit, false, not genuine. The circumstances under which the stock is proposed to be issued and sold, as above stated, are that the corporation has actual need of money for the purposes of its business, that the stock is proposed to be sold at the actual market value of the stock of the corporation, and to be sold only in such quantities as may produce the requisite funds. Under such circumstances, we think it can not be held that the issue is fictitious. Perhaps it might be asked at what price should stock be offered for sale in order to make the issue fictitious. We apprehend that no direct and positive answer can be given. The constitution has given no definition of the word "fictitious"; it has not declared what was meant by the use of that word, further than what the word itself implies, taken in connection with the context. We apprehend that in ascertaining the purport of the word, or rather its application, we must take into consideration the surrounding circumstances. Of the stock proposed to be issued, *there is no one share* upon which a person can place his finger and say that share is or will be feigned, imaginary, not real, counterfeit, false, not genuine.

\* \* \*

Affirmed.

*Note. Accord:* 1882, Peoria & S. R. Co. v. Thompson, 103 Ill. 187; 1886, Memphis & L. R. Co. v. Dow, 120 U. S. 287. See next case.

Compare 1902, Vermont Marble Co. v. Declez Granite Co., 135 Cal. 579, 58 L. R. A. 728.

The difficulty of determining the real meaning of a provision that "no corporation shall issue stock or bonds except for money, labor done, or money or property actually received; and all fictitious increase of stock or indebtedness shall be void," is well illustrated by Head, J., in, 1895, State v. Webb, 110 Ala. 214, on 228, where he says: "Can no stock or bonds issue by any corporation, until it has actually received full payment for the stock or the full consideration of the bonds? Must the money or property have been received, or the labor actually performed, before the subscriber can become a stockholder? If so, are stock or bonds issued without such prepayment intended to be declared void by the provision in question, and, if so, what is their nature, in respect to their validity, when put upon the market and passed into the hands of *bona fide* purchasers? Does the general principle that a contract or obligation, even of a commercial character, which is denounced void as against public policy, by the written law, is void even in the hands of *bona fide* holders, apply, under this constitutional provision, so as to render utterly invalid, in all hands, stock issued by a corporation, within the limits of its authorized capital, if full payment therefor has not been received, or if fraudulently issued, as fully paid up, without consideration, or for a grossly inadequate consideration? Or does the provision in question, as held by some of the courts, mean to declare void only stock and bonds which are wholly fictitious?"

**Sec. 687. Same.** (b) Liability upon fictitiously issued stock:  
 “No corporation shall issue stock or bonds, except for money paid, labor done, or property actually received, and all fictitious increase of stock or indebtedness shall be void.”

**VAN CLEVE ET AL. V. BERKEY ET AL.; BRETTELLE ET AL., APPELLANTS.**<sup>1</sup>

1898. IN THE SUPREME COURT OF MISSOURI, 143 Mo. Rep. 109-137, 42 L. R. A. 593, 8 Am. & E. C. C. N. S. 177.

[Proceeding in equity by judgment creditors of the Braun Manufacturing Company against it and its stockholders to charge the latter as owners of unpaid shares, with a sum sufficient to pay the unpaid judgments. The corporation was formed under the Illinois law, with a proposed capital stock of \$100,000, \$90,000 of which were issued to one Braun, as full paid and non-assessable, in consideration of the transfer of a French patent for an improved milling process, and an application for a United States patent for the same. The other \$10,000 were issued—\$2,000 to each of four persons, and \$1,000 to each of two persons—for which not to exceed ten per cent. was paid, and this only for purposes of securing a patent from the United States, and completing a machine, neither of which was ever accomplished. Plaintiffs' claims were for furnishing material for constructing the machinery. The court below held that the stock was not fully paid, and charged the defendants with liability. Two of these, who were not original subscribers, but who had purchased shares from original subscribers, after full investigation and information as to how the stock had been paid for, appealed. It was found “that all of the defendants acted in good faith, so far as their actual intentions were concerned, and that none of them was moved by any actual fraudulent intent in the transaction,” but further that “they did not consider the invention to be worth the amount of money for which it was to be put into the corporation.”]

BRACE, J. \* \* \* 1. Counsel for the appellants, taking the opinion of the learned trial judge as a text for his argument for a reversal of the decree in favor of plaintiffs, in effect concedes the facts to be as stated in the opinion and the case thereby made; but contends that thereupon the judgment should have been for the appellants for the reason that it is not alleged in the petition, nor shown by the evidence, that the stockholders, in capitalizing the Braun invention, or rather the agreement to transfer the same to the corporation at the sum of \$100,000 and issuing therefor full paid non-assessable stock to that amount, actually intended to defraud creditors of the corporation or purchasers of its stock—although in point of fact that invention had not at the time, nor ever since has had, any real, intrinsic or market value. In other words, the contention is that as the corporation could receive

<sup>1</sup> Statement abridged; arguments and part of opinion omitted.



property in payment for its capital stock, and did in fact accept the valueless Braun invention in full payment thereof, in the absence of actual fraud upon the part of the corporators, charged and affirmatively proven *aliunde* the transaction, the appellants' stock, as to the creditors of the corporation, was fully paid for, and they should have had judgment.

A. In order to determine what support is given to this proposition by the authorities, it may be well, *first*, to eliminate those cases which are not in point upon the facts of this case. By this process that class of cases may be excluded from consideration in which it has been held that, in the absence of fraud as between the corporation or its representative and its stockholders, that which they have agreed on as payment shall be treated as payment, of which *Coffin v. Ransdell*, 110 Ind. 417, cited by appellants, is an example. In this class may also be included those cases in which it is held that the same rule applies as between the stockholder and an innocent purchaser of the stock, issued as full paid and non-assessable, in good faith for value, without notice of the actual consideration paid by the subscribers thereof, of which the following are illustrations: *Phelan v. Hazard*, 5 Dill. 45; *Brant v. Ehlen*, 59 Md. 1. So, also, may be excluded from our consideration as not in point, those cases in which it is held that a creditor who extends credit to a corporation with actual notice of the acceptance by the corporation of property at a fixed value, in full payment for its capital stock, is estopped from denying that the capital stock is fully paid, of which the following are illustrations: *Bank v. Alden*, 129 U. S. 372; *Walburn v. Chenault*, 43 Kan. 352; *Whitehill v. Jacobs*, 75 Wis. 474; *Woolfolk v. January*, 131 Mo. 620. As to the last case, however, something further will be said later on. None of these, or like cases, apply, for the reason that we have here a case in which the appellants stand in the shoes of the original subscribers by reason of the fact that they accepted their stock after due inquiry and with full knowledge of the fact that it was paid for by the Braun invention; and the plaintiffs are simply creditors of the corporation who extended credit to it upon the faith of its capital stock. We are to inquire what is the rule between such a creditor and such a stockholder.

B. It seems that in all the states, either by force of statutory enactment or judicial construction, property may now be taken in payment of the capital stock of a corporation, but as was aptly remarked by Depue, J., in *Wetherbee v. Baker*, 35 N. J. Eq. 501, such transactions "have been upheld only where \* \* \* the purchase of property has been made in good faith and the property taken in payment of stock subscriptions has been put in at a fair *bona fide* valuation; and the courts have inflexibly enforced the rule that payment of stock subscriptions is good as against creditors only where payment has been made in money or in what may fairly be considered as money's worth." The soundness of this doctrine has been recognized almost universally; yet, when we come to inquire how the courts have enforced this rule, as between a creditor and a stockholder, pure and

simple, we find a line of cases in which it is, or seems to be, held that where property has been taken at a value less than the par value of the stock for which full-paid non-assessable stock is issued, in the absence of an affirmative showing of fraud, the overvaluation will not render the stockholder liable for the difference. *Bickley v. Schlag*, 46 N. J. Eq. 533; *Coit v. Gold Amalgamating Co.*, 119 U. S. 343; *Boynton v. Andrews*, 63 N. Y. 93; *Douglass v. Ireland*, 73 N. Y. 100; *Van Cott v. Van Brunt*, 82 N. Y. 535; *Lake Superior Iron Co. v. Drexel*, 90 N. Y. 87; *Gilkie & Anson Co. v. Dawson Town & Gas Co.*, 46 Neb. 333; *Kelley v. Fletcher*, 94 Tenn. 1; and in support of this doctrine we are also cited by counsel for appellants to the cases of *Fogg v. Blair*, 139 U. S. 118; *Clark v. Bever*, 139 U. S. 96; and *Handley v. Stutz*, 139 U. S. 417. It is to be observed, however, in regard to all of these cases from the supreme court of the United States, that in the earlier cases it was held as the settled doctrine of that court that a contract, whereby property was accepted at a value less than the par value of the capital stock, in payment for its shares issued as full-paid, that "such a contract, though binding on the company, is a fraud in law on its creditors which they can set aside; that when their rights intervene and their claims are to be satisfied, the stockholders can be required to pay their stock in full." *Scovill v. Thayer*, 105 U. S. 154; *Sawyer v. Hoag*, 17 Wall. 610; *New Albany v. Burke*, 11 Wall. 96; *Burke v. Smith*, 16 Wall. 390 \* \* \* [citing, quoting from and commenting upon, *Camden v. Stuart*, 144 U. S. 104; *Clark v. Bever*, 139 U. S. 96; *Fogg v. Blair*, 139 U. S. 118; *Handley v. Stutz*, 139 U. S. 417; *National Tube Works v. Gilfillan*, 124 N. Y. 302; *Coleman v. Howe*, 154 Ill. 458, and showing] that the appellants would be charged as holders of unpaid stock in an action like unto this; and it is beyond question that they might be so held, regardless of the question of actual fraudulent intent under the ruling of the court of appeals of New York in *Boynton v. Hatch*, 47 N. Y. 225, and *Nat. Tube Works v. Gilfillan*, *supra*; under the ruling of the supreme court of Ohio (*Gates v. Tippecanoe Stone Co.* (1897), 48 N. E. Rep. 285); and of the supreme court of Minnesota (*Hastings Malting Co. v. Iron Range Brewing Co.*, 65 Minn. 28; *Hospes v. Northwestern Co.*, 48 Minn. 174); of Washington (*Manhattan Trust Co. v. Seattle Coal Co.*, 16 Wash. 499; *Adamant Man. Co. v. Wallace*, 16 Wash. 614); of Utah (*Henderson v. Turngren*, 9 Utah 432; *Salt Lake Hardware Co. v. Tintic Milling Co.*, 13 Utah 423); of Alabama (*Elyton Land Co. v. Birmingham, etc., Co.*, 92 Ala. 407); and of Iowa (*Osgood & Moss v. King*, 42 Iowa 478; *Chisholm Bros. v. Forny*, 65 Iowa 333; *Bolten Carbon Co. v. Mills*, 78 Iowa 460). \* \* \*

Satisfied that the weight of the American authority outside of this jurisdiction is against the appellants' contention on the facts of this case, and that they would thereby be held liable, as by the court below, without other proof of fraud than was afforded by the transaction itself, we will now turn to the law of Missouri, without further notice of the many cases we have examined from other jurisdictions..

By the constitution of 1875, article 12, section 8, it is provided that "no corporation shall issue stock or bonds, except for money paid, labor done, or property actually received, and all fictitious increase of stock or indebtedness shall be void." By statute it is provided that "the stock or bonds of a corporation shall be issued only for money paid or property actually received" (R. S. 1879, § 727; R. S. 1889, § 2499); and that "if any execution shall have been issued against any corporation and there can not be found any property or effects whereon to levy the same, then such execution may be issued against any of the stockholders to the extent of the amount of the unpaid balance of such stock by him or her owned" (R. S. 1879, § 736; R. S. 1889, § 2517); and that "if any company, formed under this chapter, dissolve, leaving debts unpaid, suits may be brought against any person or persons who were stockholders at the time of such dissolution without joining the company in such suit." (R. S. 1879, § 745; R. S. 1889, § 2519.

Mr. Cook, the author from whom we have just quoted,<sup>1</sup> after treating of the law as it stood under the adjudications of the courts at the time this legislation was first enacted, says: "Hence, when it became clear that the common law did not prevent the issue of watered stock, but compelled the public to rely not upon statements of the capital stock, but upon an investigation of the actual condition of the company, a demand arose for statutes and constitutional provisions to protect the people from watered stock. This demand gave rise to certain constitutional provisions which have been enacted in several states. These provisions are very similar in their wording, and are substantially as follows: 'No corporation shall issue stocks or bonds except for money, labor done, or money or property actually received, and all fictitious increase of stock or indebtedness shall be void.' It is now twenty years since the first of these provisions was enacted, and yet it may be said that these constitutional provisions have decidedly failed to remedy the evil they were expected to cure." Section 47.

In the recent case of Elyton Land Co. v. Birmingham Warehouse and Elevator Co., 92 Ala. 423, in an able opinion, after an extended review of the authorities, Walker, J., speaking for the court, says: "Our examination satisfies us that the weight of American authority does not support the statement made by Mr. Cook, in section 47 of his work on Stocks and Stockholders, to the effect that the attempts which have been made, in cases where stock was issued for property taken at an overvaluation, to hold the party receiving such stock liable for its full par value, less the actual value of the property received from him, have been unsuccessful; and that if there has been an overvaluation which is shown to have been fraudulent, then the contract is to be treated like other fraudulent contracts, and is to be adopted *in toto* or rescinded *in toto* and set aside. We have found no authority at all asserting the exemption of the stockholder from such liability where it appeared that the stock subscription was governed by a statutory regulation at all similar to section 1805 of the code of 1876, or section 1662 of the code of 1886. On the other hand, the New

<sup>1</sup> See section 46.

York, New Jersey, Maryland and Pennsylvania decisions which have been cited show that the courts in those states, in giving effect to statutory requirements, certainly no more stringent than ours, as to the mode in which stock subscriptions shall be made payable, do not allow attempted payments in property worth greatly less than the amount of stock issued therefor to foreclose the just demands of corporate creditors to require that the stock subscriptions be made good in money or in money's worth as contemplated by the statutes. Those courts recognize in such provisions safeguards intended for the protection of persons dealing with corporations as well as for the corporations themselves and the persons associated together therein.

Our general laws afford the amplest and freest facilities for persons desiring to engage in almost any kind of lawful venture to secure by corporate association the advantages of defined and limited responsibility and at the same time the efficient execution of their purposes by means of an artificial being, changes in the membership of which cause no break in the continuity of its action nor affect its capacity to act, within the scope of its powers, as a natural person. It is plain that such associations, endowed with such powers and privileges, would be a source of danger to persons dealing with them, unless the law required that in their formation suitable provisions be made for a substantial responsibility for such engagements as they may enter into. When legal provisions are found which are appropriately framed to secure the existence of such responsibility it is not permissible so to construe them as to allow a mere formal and illusory compliance therewith to defeat the objects intended to be accomplished. No argument is needed to show that a requirement that the stock of a corporation shall be paid in money, or in labor or property at its money value, inures to the benefit of persons who may become creditors of the corporation, in that it requires the capital stock to be the representative of substantial values and insure the existence of a fund which must be within the reach of the satisfaction of debts if the affairs of the corporation are managed as contemplated by the law. It is equally clear that if a stock subscription which is required to be made payable in money, or in labor or property at its money value, and is in fact made payable in property at a designated money valuation, may be satisfied by the transfer of property the value of which is insignificant or merely nominal as compared with the valuation stated, then, so far as this provision of the law looks to the protection of creditors, it might as well have allowed the subscription to be made payable in "chips and whetstones."

The Missouri cases decided since the adoption of our present constitution and the enactment of the statutes aforesaid, give no countenance to the idea that these provisions have failed of their purpose in this state. \* \* \*

(Citing and quoting from *Chouteau v. Dean*, 7 Mo. App. 210; *Gill v. Balis*, 72 Mo. 424; *Chouteau Ins. Co. v. Floyd*, 74 Mo. 286; *Kehlor v. Lademann*, 11 Mo. App. 550; *Liebke v. Knapp*, 79 Mo. 22.)

In the next case, *Shickle v. Watts*, 94 Mo. 410, decided by this

court in 1887, which was a suit by a judgment creditor against a stockholder of an Illinois corporation in the nature of a creditor's bill, as in the case in hand, in which it was alleged that the defendant was the owner and holder of a large number of shares of the stock of the company, subscribed and issued to him, and on which no payment whatever was made, it was held "that where an agreement is entered into between a contractor and a corporation whereby the former is to perform work for or furnish material to the latter and to take unpaid stock in part or in full payment, that such contractor, whether for labor or material, can only charge therefor the reasonable market value for such labor thus given in exchange, and that all agreements by the corporation to pay more than such reasonable compensation will be disregarded and held for naught by the courts when the rights of creditors intervene. And this is the case, even though no fraud is proven," and it was accordingly so ruled in the judgment in that case. \* \* \*

(Citing and quoting to the same effect from *Farmers' Bank, etc., v. Gallaher*, 43 Mo. App. 482; *Leucke v. Tredway*, 45 Mo. App. 507; *Garrett v. Kansas City, etc., Co.*, 113 Mo. 330; *Ramsey v. Thompson Mfg. Co.*, 116 Mo. 313.)

In the next case, *Shepard v. Drake*, 61 Mo. App. 134, decided by the Kansas City Court of Appeals, and which was a proceeding by motion under section 2517, Revised Statutes 1889, it was held that: "It is now the well-settled doctrine in this state that while the stock of a corporation may be paid for in money, labor or property of any kind used in the business, yet such stock will not, as to the corporation creditors, be deemed fully paid unless such money, labor or property shall at the time be the fair equivalent of the stock's par value. In other words, mere fictitious values placed on labor or property in payment for stock will be ignored, and the shareholder will get credit on his subscription for the real value of the labor or property, nothing more, and be compelled at the suit of a corporation creditor to pay up the balance. And this rule seems to hold in this state, whether the overvaluation of the property received by the corporation be the result of fraud, mistaken estimate or bad judgment."

In the next and last case, *Woolfolk v. January*, 131 Mo. 620, decided by Division No. 2 of this court, December 17, 1895, and upon which appellants mainly rely for a reversal of the judgment in this case, and which was a proceeding by motion for execution against the stockholder by purchase from an original stockholder, upon an allegation that the defendant's stock was wholly unpaid for; and in which it appeared from the evidence that the plaintiff was a judgment creditor on bonds issued by the corporation in part payment of a gas plant in the city of Nevada, which plant and its franchise had been accepted by the company at a valuation equal to the par value of the stock in full payment of its capital stock and said bonds; and in which the court found, upon the admission of plaintiff himself, that he purchased the bonds with full knowledge of the transaction; it was held that the plaintiff was estopped from claiming that defendant's stock was not fully paid up. This is the full scope of the de-



cision upon the facts in judgment in that case. The ruling is in harmony and entirely consistent with the rulings in all the cases in this state which we have cited and affords no support to plaintiff's contention. In fact, "the boot is on the other leg," for here it is the appellants who accepted their stock with full knowledge that it had been paid for only by the agreement to transfer a hoped-for patent in the worthless Braun invention, and who, upon the same principle, should be estopped from claiming that their stock was thereby fully paid for in an action by a creditor who, without notice, extended credit to the corporation upon the faith of its capital stock being fully paid as required by law.

Upon a review of all the cases decided by the appellate courts of this state since the adoption of the constitution of 1875, the rulings in all of which will be found to be in harmony, it is impossible to escape the conviction that in this state, whatever may be the case in some of the other states, the American trust doctrine, as suggested by Mr. Justice Harlan, has indeed been "reinforced" by its constitution and statutes, and that the proposition that the stock of a corporation must be paid for "in meal or in malt," in money or in money's value, is not a mere figure of speech, but really has the significance of its terms. It may be paid for in property, but in such case the property must be the fair equivalent in value to the par value of the stock issued therefor; that it is the duty of the stockholders to see that it possesses such value; that when a corporation is sent forth into the commercial world, accredited by them as possessed of a capital in money, or its equivalent in property, equal to the par value of its capital stock, every person dealing with it, unless otherwise advised, has a right to extend to it on the faith of the fact that its capital stock has been so paid and that the money or its equivalent in property will be forthcoming to respond to his legitimate demands. In short, that it is the duty of the stockholders and not of the creditors to see that it is so paid; hence, the inquiry in a case between the creditor and a stockholder, when property has been paid in for the capital stock of a corporation, is not whether the stockholder believed or had reason to believe that the property was equal in value to the par value of the capital stock, but whether, in point of fact, it was such equivalent. This wholesome and salutary doctrine, beneficial alike to the general public and to all corporations doing business with *bona fide* capital, so firmly applied in *Shickle v. Watts*, *supra*, and so well formulated in the foregoing quotation from the opinion of Gill, J., in the case of *Shepard v. Drake*, *supra*, ought not to be in any way weakened or impaired by anything said in the opinion in the case of *Woolfolk v. January*, in criticism of a single expression in the opinion in *Shickle v. Watts*, and which criticism was *obiter* to the case then in hand.

Applying this doctrine to the facts of the case now under consideration the appellants are obviously left without a single shred of claim to the reversal of the judgment of the circuit court, which is, therefore, affirmed. All concur.

*Note.* See preceding case and, 1887, *Fitzpatrick v. Pub. Co.*, 83 Ala. 604; 1888, *Williams v. Evans*, 87 Ala. 725; 1889, *Arkansas R. L. T. & C. Co. v. Farm-*



ers' L. & T. Co., 13 Colo. 587; 1891, Fogg v. Blair, 139 U. S. 118; 1893, Hoffman v. Bloomsburg & S. R., 157 Pa. St. 174; 1895, Coleman v. Howe, 154 Ill. 458, 45 Am. St. Rep. 133; 1895, Stockton Comb. H. & A. Works v. Houser, 109 Cal. 1; 1898, Manhattan Trust Co. v. Seattle Coal & I. Co., 19 Wash. 493, 53 Pac. Rep. 951; 1898, Troup v. Horbach, 57 Neb. 644, 74 N. W. Rep. 326; 1902, Vermont Marble Co. v. Declez Granite Co., 135 Cal. 579, 56 L. R. A. 728.

## Sec. 688. 8. Remedy of creditors.

(a) Conditions precedent; in general, exhaust remedies against corporation.

See Hollins v. Brierfield Coal & I. Co., 150 U. S. 371, *supra*, p. 1868; Slee v. Bloom, 19 Johns. 456, *supra*, p. 881.

*Note.* In case of stock issued at a discount, or that is not full paid, only subsequent creditors, without knowledge of the facts, can complain: 1890, First Nat'l Bank of Deadwood v. Gustin, 42 Minn. 327; 1892, Hospes v. N. W. Car Co., 48 Minn. 174, *supra*, p. 1910. See 1900, Hall v. Henderson, 134 Ala. 455, 63 L. R. A. 673.

*Subsequent* creditors, who know stock was issued for property at an overvaluation, can not complain: 1900, State Trust Co. v. Turner, 111 Iowa 664, 82 N. W. Rep. 1029, *supra*, p. 1943.

Generally the creditor must first exhaust his remedy against the corporation: 1875, Kincaid v. Dwinelle, 59 N. Y. 548; 1882, Handy v. Draper, 89 N. Y. 334; 1894, Hunting v. Blun, 143 N. Y. 511; 1898, Wehn v. Fall, 55 Neb. 547, 70 Am. St. Rep. 397; 1899, Gillin v. Sawyer, 93 Maine 151, 44 Atl. Rep. 677.

But this rule does not apply where the creditor proceeds upon the theory that there is no valid corporation: 1899, Tennessee Automatic L. Co. v. Massey, — Tenn. Ch. App. —, 56 S. W. Rep. 35.

There is no set-off allowed in favor of creditor shareholders. See *supra*, § 673, note; 1903, Shields v. Hobart, 172 Mo. 491, 95 Am. St. R. 529, 72 S. W. 669.

## Sec. 689. Same. (b) At law and in equity.

GOLDTHWAITE, J., IN ALLEN ET AL. V. MONTGOMERY RAILROAD COMPANY ET AL.

1847. IN THE SUPREME COURT OF ALABAMA. 11 Ala. Rep. 437-456, on 449, 450.

[Bill by judgment creditors of the railroad company to reach equitable assets of the corporation and have them applied to the payment of their claims. It seems these assets included (1) rights of the corporation upon subscriptions to the capital stock, for part of which calls had been made, which were due and unpaid, and for the balance of which no calls had been made; and (2) rights to property alleged to have been fraudulently conveyed, the conveyance of which was asked to be set aside. After holding the bill was not multifarious—because all these rights were assets of the company which the creditors had a right to pursue in equity, and to have all obstructions to their proper application removed—continued:]

2. We come now to consider what is the equity of the bill as against each class of the defendants. As to those stockholders who were in default in paying their subscriptions after the calls of the corporation (if indeed the bill shows there were any such), it is certain these could be reached by the ordinary course of law as debtors to the corporation. (7 Ala. Rep. 51; 5 Ala. Rep. 403, 787.) And therefore as against such, it may be considered the bill will not lie, as no additional equitable circumstances are stated to give jurisdiction to the court.

3. As to stockholders on whom no calls had been made under the charter (which we understand is the case intended to be presented by the bill), a different rule obtains. If the act of 1841 (Dig. 261, §10) is to be construed as allowing garnishee process when the corporation itself has made no calls, it does not cover this case, for the bill was exhibited before that act was passed; and it is certain they were not liable to that process under the previous legislation, for the indebtedness was incomplete until a call was made pursuant to the charter. *See cases last cited.* Has then a court of equity the authority to reach subscriptions for stock to satisfy a creditor when there is a deficiency of legal assets, in the absence of any call by the corporation upon its stockholders? That it has, is, we think, a clear position, as well on principle as authority. As the individual corporators are not themselves personally responsible for the contracts of the corporation, there is no responsibility anywhere, if the capital stock is not a fund answerable to the creditors, and it would seem to make no difference in the right whether this capital stock or fund existed in property or equitable assets. Nor can it vary the right if the legislature, instead of requiring the stock to be paid in has permitted the corporation to call for it as their necessities or the convenience of stockholders may require. In the latter case, the subscription is a debt which the corporation may call for, and if debts are contracted beyond the assets in hand, it would be most inequitable to neglect or refuse to make the call so as to discharge the debt. It is on this obvious principle that a court of equity assumes jurisdiction and compels the corporation and stockholders to do that which justice requires—that is, to discharge the debt to the extent that the capital stock remains in the hands of the stockholder. In *Wood v. Dummer*, 3 Mason 308, individual stockholders were held liable where the capital of the corporation had been paid out to them even after its insolvency and dissolution. The equity of the creditor, as it seems to us, is equally strong where the stockholder has contracted to pay, but has never paid his portion of the capital stock. Hence, we conclude the creditor has the right to pursue a stockholder when there is not sufficiency of legal assets, although the corporation has made no calls. \* \* \*

*Note.* As to multifariousness, see, 1894, *O'Bear Jewelry Co. v. Volfer*, 106 Ala. 205, 54 Am. St. Rep. 31; 1896, *First National Bank v. Peavey*, 75 Fed. Rep. 154; 1896, *See v. Heppenheimer*, 55 N. J. Eq. 240; also 1900, *Hall v. Henderson*, 134 Ala. 455, 63 L. R. A. 673, note.

Sec. 690. Same. (c) In the United States courts.

SHIRAS DISTRICT JUDGE, IN FIRST NATIONAL BANK OF SIOUX CITY v. PEAVEY.

1895. IN THE UNITED STATES CIRCUIT COURT, N. D. IOWA, W. D. 69 Fed. Rep. 455-460, on 457, 458, 459, 1 Am. & E. Corp. Cas. (N. S.) 648.

[Action brought in the Iowa courts by the bank, as judgment creditor of the Sioux City Street Railway Company, against Peavey, a Minnesota stockholder of that company, to hold him liable upon the ground that he had never paid anything for the shares he owned, and for which he had subscribed (the terms of the subscription not being set forth). Peavey removed the suit to the United States Circuit Court. The pleadings raised the question as to the proper method of proceeding, whether as provided by the Iowa statute, or by an action at law, or by a bill in equity.]

In the briefs of counsel much space is devoted to the point whether the federal court is bound by the rulings of the state supreme court upon similar questions of practice. The rule, as I gather it from the decisions of the supreme court, is, that where a state statute creates a right in favor of creditors, and provides a remedy for the enforcement of the right thus created, then this remedy, whether at law or in equity, must be adopted, regardless of the tribunal in which the proceedings are had. If, however, the state statute does not create the right sought to be enforced, but only redeclares it, so that it would exist in the absence of the state statute, then it exists as a provision of the general or common law, and when its enforcement is sought in the federal courts the form of the remedy is determined by the principles which differentiate legal and equitable jurisdiction in these courts. *Pollard v. Bailey*, 20 Wall. 520; *Mills v. Scott*, 99 U. S. 25; *Terry v. Little*, 101 U. S. 216; *Bank v. Francklyn*, 120 U. S. 747, 7 Sup. Ct. 757; *Clark v. Bever*, 139 U. S. 96, 11 Sup. Ct. 468. The decision of the supreme court in *Sawyer v. Hoag*, 17 Wall. 610, and numerous later rulings based thereon, have firmly established the principle that the unpaid portions of corporate capital stock form a trust fund for the benefit of the creditors of the corporation. The right of the creditor to look to this fund for the payment of corporate debts is not created by state statute, but is derived from general existing legal principles, and therefore its enforcement in federal courts is not dependent upon the existence of remedies provided by state legislation. The petition in the case now before the court is clearly based upon the general principle recognized in *Sawyer v. Hoag*, *supra*. \* \* \*

The question whether this is a purely equitable right, not available in an action of law, is one upon which the decisions are not in accord. Upon principle the true rule, it seems to me, is that where a person has subscribed for or purchased stock in a corporation under such circumstances that the corporation, and through it the creditors of the

corporation, can call upon the stockholders for payment of the unpaid portion of the capital stock, then this claim is one at law, based upon the express or implied terms of the subscription or purchase of the stock. If subsequently to the subscription or purchase, thus creating a contract right to call for the unpaid portions of the stock, an agreement is entered into between the corporation and the stockholder whereby the latter is released from liability on the stock held by him, this release, though good between the corporation and stockholders, may not be binding upon creditors, if injurious to them, or in fraud of their rights; and as they are not parties to it, its validity may be attached in an action at law. In such a case the plaintiff's right of action at law would be based upon the legal effect of the original contract of subscription or purchase, and the contract of release would be a matter of defense, and when relied on as such its validity would be open to investigation in the law action. If the release was found to be valid, not only as against the corporation, but also against the creditors, it would then be a good defense against the action based upon the original contract of subscription or purchase. If, however, the release was found to be in fact in fraud of the rights of creditors, then it would not be binding upon them, and would not constitute a defense to the law action based upon the subscription, and the judgment would go in favor of the creditor upon the legal right of recovery created by the contract of subscription or purchase. If, however, by the terms of the original subscription or purchase, no liability is assumed by the stock purchaser to the corporation for any further payments upon such stock, and it is agreed, as part of the contract of subscription or purchase between the corporation and the stockholders, that the stock shall be deemed to be full paid, and it is issued in this form, then the creditors' rights, if any, are equitable, and can not be enforced in an action at law unless the statute of the state so provides. In such case the creditors can not declare at law upon the original contract of subscription, for it created no legal cause of action. The right of the creditors in such case is based upon the equitable doctrine that the capital stock is deemed to be a trust fund created for the benefit and protection of the creditors of the corporation. Unless expressly so authorized by statute, a court of law can not enforce equities unless there is also a cause of action at law as the basis of the proceeding. In cases wherein a person has subscribed for or purchased stock in a corporation, and by the terms of subscription or purchase, viewed as a contract between the corporation and the stockholders, the latter is not bound for any further payments on the stock, but is expressly released therefrom, the creditors have no legal ground for recovery against the stockholder on this contract of subscription, but they may appeal to the court for relief upon the equitable grounds already suggested. \* \* \*

If it be further true that the statute of Iowa creates a remedy at law for the enforcement of equitable rights, then it follows that a litigant in the federal court has a choice of remedies. He may avail himself of the new statutory legal remedy, if it be sufficient to meet the ex-

igencies of the particular case, or he may proceed under the undoubted equitable jurisdiction which exists in the federal court, and which is not destroyed or limited in any degree by the creation of a legal remedy by state legislation. \* \* \*

Demurrer overruled.

*Note.* Compare, 1879, Ladd v. Cartwright, 7 Ore. 329; 1882, Patterson v. Lynde, 106 U. S. 519.

**Sec. 691. Same. (d)** Mandamus, or suit in equity, to have calls made.

JACKSON, J., IN THE DALTON & MORGANTOWN R. CO. v. McDANIEL.

1876. IN THE SUPREME COURT OF GEORGIA. 56 Ga. Rep. 191-196, on 195.

[Bill in equity by unsatisfied judgment creditors of the railway company against it and its shareholders to compel the latter to pay such sums upon the unpaid stock as necessary to pay the corporate creditors. The bill was demurred to upon various grounds, one of which was that the charter required the directors to make all calls, and the subscription agreement was to pay only on the call of the directors. The directors had refused, when requested, to make the necessary calls.]

It is not necessary to apply for a mandamus to compel the directors to call in and collect a sufficient amount of the stock to pay these debts. The remedy by bill in equity is easier and more complete. With its power to appoint an auditor or master in chancery to audit the amount of the debts of the corporation in gross and the debt due to each creditor, to ascertain the number of stockholders solvent and insolvent, the per cent. necessary to be paid by each stockholder in proportion to his stock, it is perfectly clear that complete justice can be better administered to every creditor and to each solvent stockholder by a court of equity than by any other form of procedure. It will prevent multiplicity of suits, save costs, and give speedy and effectual relief. Principle, therefore, and sound reason accord with authority that equity will grant relief in all such cases as this at bar. Ang. on Corp. 602, 603, 611; 8 Georgia Reports 492.

*Note.* Compare, 1832, King v. Katharine Dock Co., 4 B. & Ad. 360, 24 E. C. L. 73; 1841, Queen v. The Victoria Park Co., 1 Ad. & El. 288, 41 E. C. L. 544; 1844, Ward v. Griswoldville Mfg. Co., 16 Conn. 593; 1848, Henry v. Railroad Co., 17 Ohio 187.

See next case.

## Sec. 692. Same. (c) Parties.

HATCH v. DANA.<sup>1</sup>

1879. IN THE SUPREME COURT OF THE UNITED STATES. 101  
U. S. Rep. 205-215.

[Appeal from circuit court of United States for southern district of Illinois. Dana, an unsatisfied judgment creditor of the Chicago Republican Company, an insolvent Illinois corporation, brought suit in equity on behalf of himself and all other creditors coming in and contributing to the expenses of the suit against the company, Hatch, Williams and other Illinois stockholders, to collect 80 per cent. alleged to be unpaid upon stock subscriptions, or so much as was necessary. Afterward plaintiff dismissed the bill as to all except Hatch and Williams, who answered, admitting most of the facts of the bill, except the claims of the plaintiff (of which they asked he be required to make full proof), giving the names of other shareholders, and asking that all these be made parties, and an accounting be had, and they be held only for their *pro rata* share. Replication was filed, and the court gave judgment for Dana for \$9,398.72 against Hatch and Williams, but not more than \$7,000 with interest to be collected from either one, that being the sum that each was found to owe to the corporation. Defendants appealed.]

MR. JUSTICE STRONG. This bill is an ordinary creditor's bill, the sole object of which is to obtain payment of the complainant's judgment. It is true it is brought on behalf of the complainant and all other creditors of the corporation who might choose to come in and seek relief by it, contributing to the expense of the suit. But no other creditors came in, and it does not appear that there is any other creditor, unless it be one of the stockholders, who was made a defendant, and who filed a cross-bill, which he afterwards dismissed. All the stockholders were not made defendants.

The bill was not a bill seeking to wind up the company. It sought simply payment of a debt out of the unpaid stock subscriptions.

That unpaid stock subscriptions are to be regarded as a fund, which the corporation holds for the payment of its debts, is an undeniable proposition. But the appellants insist that a creditor of an insolvent corporation is not at liberty to proceed against one or more delinquent subscribers to recover the amount of his debt, without an account being taken of other indebtedness, and without bringing in all the stockholders for contribution. They insist, also, that by the terms of the subscriptions for stock made by these appellants they were to pay for the shares set opposite their names respectively, "as called for by the said company;" that the company made no calls for more than thirty per cent.; that, therefore, this company could not recover the seventy per cent. unpaid without making a previous call; and

<sup>1</sup> Statement abridged, arguments and part of opinion omitted.



that a court of equity will not enforce the contract differently from what was contemplated in the subscription.

These positions, we think, are not supported by the authorities,—certainly not by the more modern ones,—nor are they in harmony with sound reason, when considered with reference to the facts of this case. The liability of a subscriber for the capital stock of a company is several, and not joint. By his subscription each becomes a several debtor to the company, as much so as if he had given his promissory note for the amount of his subscription. At law, certainly, his subscription may be enforced against him without joinder of other subscribers; and in equity his liability does not cease to be several. A creditor's bill merely subrogates the creditor to the place of the debtor, and garnishes the debt due to the indebted corporation. It does not change the character of the debt attached or garnished. It may be that if the object of the bill is to wind up the affairs of this corporation, all the shareholders, at least so far as they can be ascertained, should be made parties, that complete justice may be done by equalizing the burdens, and in order to prevent a multiplicity of suits. But this is no such case. The most that can be said is that the presence of all the stockholders might be convenient, not that it is necessary. When the only object of a bill is to obtain payment of a judgment against a corporation out of its credits or intangible property, that is, out of its unpaid stock, there is not the same reason for requiring all the stockholders to be made defendants. In such a case no stockholder can be compelled to pay more than he owes.

In *Ogilvie v. Knox Insurance Co.* (22 How. 380) the question was considered. That was a case in which several judgment creditors of a corporation had brought a creditor's bill against it and thirty-six subscribers to its capital stock. The bill alleged that the complainants had recovered judgments against the company upon which executions had been issued, and returned "no property;" that the other defendants had severally subscribed for its stock, and that the subscriptions remained unpaid, payment not having been enforced by the company. The prayer of the bill was that these other defendants might be decreed to pay their subscriptions, and that the judgments might be satisfied out of the sum paid. It was objected, as here, that the bill was defective for want of proper parties; but the court held the objection untenable. In delivering the opinion of the court, Grier, J., said: "The creditors of the corporation are seeking satisfaction out of the assets of the company to which the defendants are debtors. If the debts attached are sufficient to pay their demands, the creditors need look no further. They are not bound to settle up all the affairs of this corporation and the equities between its various stockholders, corporators or debtors. If A. is bound to pay his debt to the corporation in order to satisfy its creditors, he can not defend himself by pleading that these complainants might have got their satisfaction out of B. as well. It is true, if it be necessary to a complete satisfaction of the complainants that the corporation be treated as an insolvent, the court may appoint a receiver, with authority to

collect and receive all the debts due to the company, and administer all its assets. In that way all the other stockholders or debtors may be made to contribute." The court, therefore, directed a decree against the respondents severally for such amounts as appeared to be due and unpaid by each of them for their shares of the capital stock.

(Citing and quoting from, to the same effect, *Bartlett v. Drew*, 57 N. Y. 587; *Pierce v. The Milwaukee Construction Co.*, 38 Wis. 253; *Marsh v. Burroughs*, 1 Woods 468; *Wood v. Dummer*, 3 Mason 308, and distinguishing *Pollard v. Bailey*, 20 Wall. 520, and *Terry v. Tubman*, 92 U. S. 156, on the ground that they related to the enforcement of a special statutory liability.) \* \* \*

We hold, therefore, that the complainant was under no obligation to make all the stockholders of the bank defendants in his bill. It was not his duty to marshal the assets of the bank, or to adjust the equities between the corporators. In all that he had no interest. The appellants may have had such an interest, and, if so, it was quite in their power to secure its protection. They might have moved for a receiver, or they might have filed a cross-bill, obtained a discovery of the other stockholders, brought them in, and enforced contribution from all who had not paid their stock subscriptions. Their equitable right to contribution is not yet lost. \* \* \*

(After holding the court could make a call if necessary and that mandamus could not apply here, because the corporation had no officers to make calls, and that the remedy in equity was more complete, the decision below was)

*Affirmed.*

*Note. Parties:*

1. One shareholder alone may be made defendant, but more or all can be and usually are joined: 1885, *Thompson v. Reno Sav. Bk.*, 19 Nev. 103, 3 Am. St. Rep. 797, note 806; 1892, *Baines v. Babcock*, 95 Cal. 581, 29 Am. St. Rep. 158; 1895, *Coleman v. Howe*, 154 Ill. 458, 45 Am. St. Rep. 133; 1898, *Parker v. Carolina Sav. Bk.*, 53 S. C. 583, 69 Am. St. Rep. 888; 1899, *Siegel v. Andrews*, 181 Ill. 350; 1899, *Walter v. Merced Academy Assn.*, 126 Cal. 582, 59 Pac. Rep. 136; 1899, *Welch v. Sargent*, 127 Cal. 72, 59 Pac. Rep. 319; 1900, *Singer v. Hutchinson*, 183 Ill. 606; 1902, *Schaub v. Welded Barrel Co.*, — Mich. —, 90 N. W. 335.

2. But one creditor can not sue in his own name for himself alone, but must sue on behalf of all, or in such a way as all creditors may join: 1882, *Patterson v. Lynde*, 106 U. S. 519; 1895, *Coleman v. Howe*, 154 Ill. 458, 45 Am. St. Rep. 133; 1898, *Van Pelt v. Gardner*, 54 Neb. 701; 1899, *State Nat'l Bank v. Sayward*, 91 Fed. Rep. 443; 1899, *Foster v. Posson*, 105 Wis. 99, 81 N. W. Rep. 123; 1899, *Brown v. Brink*, 57 Neb. 606, 78 N. W. Rep. 280.

But one creditor can not sue on behalf of himself and other creditors to enforce the Kansas statutory liability—must sue for himself alone: 1900, *Woodworth v. Bowles*, 61 Kan. 569, 60 Pac. Rep. 331.

See following cases as to assignees and receivers.

Sec. 693. Same. (f) Assignee or receiver in a foreign state.

HORACE STODDARD, ASSIGNEE OF THE SOLDIERS' WORLD'S FAIR HOTEL ASSOCIATION, APPELLANT, v. CHAUNCEY H. LUM ET AL., RESPONDENTS.<sup>1</sup>

1899. IN THE COURT OF APPEALS OF NEW YORK. 159 N. Y. Rep. 265-278, 70 Am. St. Rep. 541, 45 L. R. A. 551.

[Action by the assignee of the Hotel Association, an insolvent Illinois corporation, organized with a capital stock of \$200,000, against the New York stockholders to collect unpaid subscriptions to the stock of the association to pay creditors. The complaint alleged the corporation, as authorized by the Illinois law, had in May, 1893, executed to plaintiff a general assignment for the benefit of its creditors; that the court having jurisdiction of insolvencies found the debts then to be \$9,972; the tangible assets, \$795; and \$36,407 still due upon stock subscriptions, whereupon it ordered the assignee to bring suit against shareholders for their *pro rata* share of the debts; suit was accordingly brought in Illinois against shareholders there resident, from which only \$1,039 was collected—all the shareholders but two being found to be insolvent; upon report being made to this effect, and showing that all the shareholders outside of Illinois and New York were insolvent, and that the debts then amounted to \$11,670, \$10,432 still remaining unpaid, it was alleged that plaintiff was ordered to institute suits in New York against shareholders there, to collect the sums justly due by them; the complaint also set forth the names of fifteen New York shareholders, alleging that some of them were insolvent, but which ones were so, was unknown to plaintiff. To this complaint was annexed a schedule setting forth the provisions of the Illinois law relating to liability of stockholders. The prayer asked the court to determine the liability of each New York shareholder, and asks for a receiver, if necessary, to help enforce the same in that state. Demurrer was interposed, because the complaint showed on its face the court had no jurisdiction; did not state facts sufficient to constitute a cause of action; and that plaintiffs had no legal capacity to sue. This was overruled at the special term, but reversed by the appellate division.]

BARTLETT, J. \* \* \* The point presented by the demurrer is a very narrow one, and is in substance this: That an action against these stockholders to recover a balance due on their subscriptions, or such *pro rata* share of it as is necessary to pay the indebtedness of the company, can only be maintained in the state of Illinois, where the corporation is located, as the laws of Illinois provide a special and peculiar remedy which can be enforced only in that state.

Chapter 32 of the Revised Statutes of the state of Illinois contains the provisions involved in this controversy.

Section 8, among other things, enacts that each "stockholder shall be liable for the debts of the corporation to the extent of the amount

<sup>1</sup> Statement abridged; arguments and parts of the opinion omitted.

that may be unpaid upon the stock held by him, to be collected in the manner herein provided. \* \* \* Whenever any action is brought to recover any indebtedness against a corporation, it shall be competent to proceed against any one or more stockholders at the same time, to the extent of the balance unpaid by such stockholders upon the stock owned by them respectively, whether called in or not, as in cases of garnishment."

This is clearly an exclusive remedy, available only in the state of Illinois.

We then come to section 25 of this chapter, which is to be read in connection with the fact that a corporation may make a general assignment for the benefit of its creditors in the state of Illinois.

This section provides, among other things, that if a corporation "shall dissolve or cease doing business, leaving debts unpaid, suits in equity may be brought against all persons who were stockholders at the time, or liable in any way for the debts of the corporation, by joining the corporation in such suit, and each stockholder may be required to pay his *pro rata* share of such debts or liabilities to the extent of the unpaid portion of his stock after exhausting the assets of such corporation. And if any stockholder shall not have property enough to satisfy his portion of such debts or liabilities, then the amount shall be divided equally among all the remaining solvent stockholders."

The balance of section 25 provides for the winding up of a corporation by a court of equity and the appointment of a receiver, etc. This portion of the statute is not involved in the present action.

It will thus be seen that the plaintiff in the case at bar, clothed with the ample powers of a general assignee for the benefit of creditors, is duly authorized by the first portion of this section to proceed against stockholders and all persons liable in any way for the debts of the corporation in the interest of the creditors, the corporation having ceased to do business and leaving debts unpaid.

This provision of the statute evidently authorizes the general assignee to bring an omnibus suit in the state of Illinois in the interest of creditors against stockholders and others in any way liable to contribute to the payment of the corporate debts. The statutory limitation of recovery against a stockholder to his *pro rata* share of the debts, if it be less than the amount unpaid upon his stock subscription, is merely stating the rule in equity when marshaling the assets.

If a stockholder of an insolvent corporation owed a balance on his stock subscription of five thousand dollars, and it was made to appear that three thousand dollars was his *pro rata* share of the indebtedness, judgment could only go against him for the latter amount.

The liability now sought to be enforced does not rest upon the provisions of the statute cited, but is wholly contractual, and has for its foundation the principles of the common law. \* \* \*

The demurrer to the complaint admits that these defendants, residents of this state, are original subscribers to the stock of this Illinois

corporation, and that they are still indebted for balance due on the subscription.

This is a contract liability pure and simple, and one that the corporation, if solvent, could have enforced in the courts of this state. This cause of action, in the event of corporate insolvency, vests in the general assignee for the benefit of creditors, or in a receiver duly appointed.

It has been held that a right of action to enforce a personal liability of the stockholder for the debts of a corporation, given and created only by the statutes of the state of the corporation's domicile, is not enforceable in another state where the stockholder resides, upon any obligation of comity, but it has frequently been adjudged that the contract obligation assumed by subscribing to the stock of a corporation can be thus enforced. (*Dayton v. Borst*, 31 N. Y. 435, and cases cited.)

Subscribers to the stock of a corporation incur a debt which may be enforced by any common law or equitable remedy. (*Mann v. Cooke*, 20 Conn. 178.) The capital stock of a corporation is a fund set apart for the payment of its debts. It is a substitute for the personal liability which subsists in private co-partnerships. The creditors have a lien upon it in equity. Unpaid stock is as much a part of this pledge and as much a part of the assets of the company as the cash which has been paid in upon it. (*Sanger v. Upton, Assignee*, 91 U. S. 56.)

At pages 60, 61, of case last cited, the United States Supreme Court says, in speaking of unpaid stock subscriptions: "Creditors have the same right to look to it as to anything else, and the same right to insist upon its payment as upon the payment of any other debt due to the company. As regards creditors, there is no distinction between such a demand and any other asset which may form a part of the property and effects of the corporation." (Citing many cases.)

It would speak ill for state comity if a citizen of New York could go to Illinois and in good faith subscribe to the capital stock of a corporation and later repudiate his obligation to pay a balance due on the subscription and yet not be liable to an action at law or a suit in equity in our own courts in the name of the corporation to compel him to perform his contract.

Fortunately for state comity and commercial integrity no such rule of law exists, and a creditor whose rights rest in contract may pursue his debtor into the courts of the latter's domicile.

Several cases are cited as holding that this action is not maintainable, but they are all clearly distinguishable. \* \* \*

(Citing, quoting from, and showing that, the following cases all related to the enforcement of the purely statutory liability of shareholders, and not their common-law liability for unpaid stock subscriptions: *Marshall v. Sherman*, 148 N. Y. 9; *Barnes v. Wheaton*, 80 Hun 8; *Cleveland, L. & W. Ry. Co. v. Kent*, 87 Hun 329.)

Returning to the case at bar we have, in brief, this situation presented under the demurrer to the complaint: This action is brought

on behalf of all the creditors of the corporation, who number one hundred and fifteen or more, and is against all the original stockholders in this state, they being the only ones now liable, as all stockholders residing in states other than Illinois and New York are insolvent; the legal remedy has been exhausted against the Illinois stockholders, except that a portion of the amount due from one defendant may be collected; that some of the New York stockholders are solvent and some are not, but which of them are, and which are not, is unknown to the plaintiff; that the present indebtedness of the corporation, after crediting all amounts collected from stockholders, has been ascertained in the Illinois proceedings; that under the law of Illinois a domestic corporation may make an assignment for the benefit of its creditors, and the assignee thereunder may maintain any suit or action that the insolvent company making the assignment could have maintained if such assignment had not been made.

The sole question to be determined by us at this time is whether this action can be maintained, and we are not concerned with the practical difficulties that plaintiff may encounter in establishing to the satisfaction of the trial court the just *pro rata* share of the defendant stockholders in the payment of the indebtedness of this insolvent corporation.

We are of opinion that this action is clearly maintainable upon principle and on authority.

A subscription to the stock of a corporation creates a debt enforceable at law, or in equity, by the corporation, or its legal representative. (Sagory v. Dubois, 3 Sand. Ch. 466; Mann, Rec'r, etc., v. Pentz, 2 Sand. Ch. 257; Herkimer, etc., Co. v. Small, 2 Hill 127; Troy Turnpike & R. Co. v. McChesney, 21 Wend. 296; Mann v. Cooke, 20 Conn. 178; Hartford & New Haven R. Co. v. Kennedy, 12 Conn. 499; Hartford & New Haven R. Co. v. Boorman, 12 Conn. 530; Ward v. Griswoldville Mfg. Co., 16 Conn. 593.)

The receivers and assignees of individuals and corporations domiciled in another state are permitted, under interstate comity, to enforce the contracts of such individuals and corporations in the state of the debtor's residence. \* \* \*

(Citing Dayton v. Borst, 31 N. Y. 435; Petersen v. Chemical Bank, 32 N. Y. 21; Toronto General Trust Co. v. C., B. & Q. R. Co., 123 N. Y. 37; Mabon, etc., v. Ongley Electric Co., 156 N. Y. 196; Mann v. Cooke, 20 Conn. 178; Cooke v. Town of Orange, 48 Conn. 401.)

The case at bar is not to be distinguished in principle from the authorities cited.

The plaintiff, as the general assignee for the benefit of creditors of an insolvent corporation, is vested with the legal title of all its property and the power to reduce its assets to possession, and his title is perfect, though conferred by the law of the domicile. (Petersen v. Chemical Bank, 32 N. Y. 21.)

If, as in Dayton v. Borst (31 N. Y. 435), the receiver of a bank in New Jersey was allowed to come into our court and recover the amount



remaining unpaid of a stock subscription, why should not this plaintiff, as a general assignee, be permitted to institute a similar action? Can it be said that there is any legal distinction to be drawn between a receiver created by the order of a foreign court and a general assignee created by a foreign legislature? The plaintiff does not come here seeking to remove assets from this state to the possible prejudice of domestic creditors, but asks that he be permitted to enforce against our own citizens the performance of contracts into which they have entered in another jurisdiction.

Public policy and state comity both require that this request should be granted.

*Reversed.*

*Note.* The corporation can, through its officers, make an assignment for the benefit of creditors: 1897, *Boynton v. Roe*, 114 Mich. 401; 1898, *Calumet Paper Co. v. Haskell Ptg. Co.*, 144 Mo. 331, 66 Am. St. Rep. 425.

Or a court can appoint a receiver when necessary to preserve funds (1898, *Cameron v. Groveland Imp. Co.*, 20 Wash. 169, 72 Am. St. Rep. 28, note), though there has been no actual default made (1884, *Brassey v. N. Y. & N. E. R. Co.*, 19 Fed. Rep. 663), and even upon application by the corporation itself (1892, *Wabash, St. L. & P. R. v. Humphreys*, 145 U. S. 82, 96, 114). See, also, 1889, *The Coliseum v. Interstate L. Co.*, 123 Ala. 512, 26 So. Rep. 122; 1897, *Irwin v. The Granite State Prov.*, 56 N. J. Eq. 244, *supra*, p. 1524, note, p. 1526; and 1899, *Shinney v. N. A. Sav. L. & B. Co.*, 97 Fed. Rep. 9, *supra*, p. 1542; 1899, *Hale v. Hardon*, 95 Fed. Rep. 747.

And now generally a receiver, clothed with authority by the order appointing him, or an assignee of all the corporate assets, may sue in a foreign state, when such suit does not conflict with the policy of the state: 1895, *Parker v. Stoughton Mill Co.*, 91 Wis. 174, 51 Am. St. Rep. 881, note 885; 1898, *Swing v. Bentley, etc., Co.*, 45 W. Va. 283, 31 S. E. Rep. 925; 1898, *Hale v. Hardon*, 89 Fed. Rep. 283, 95 Fed. Rep. 747; 1898, *Castleman v. Templeman*, 87 Md. 546, 67 Am. St. Rep. 363; 1899, *Dunn v. Howe*, 96 Fed. Rep. 160; 1899, *Evans v. Pease*, 21 R. I. 189, 42 Atl. Rep. 506; 1899, *Wilson v. Keels*, 54 S. C. 545, 71 Am. St. Rep. 816; 1900, *Howarth v. Angle*, 162 N. Y. 179, 47 L. R. A. 725, *infra*, p. 2028 and note; 1901, *Bank of China, etc., v. Morse*, 168 N. Y. 458, 56 L. R. A. 139, 85 Am. St. R. 676; but see, 1903, *Hale v. Allinson*, 188 U. S. 56.

As to jurisdiction of receivers in the state and federal courts, see note 6 Am. St. Rep. 185; *Irwin v. The Granite State Prov.*, 56 N. J. Eq. 244, *supra*, p. 1524, note, p. 1526; *Shinney v. N. A. Sav. L. & B. Co.*, 97 Fed. Rep. 9, *supra*, p. 1542; also, 1898, *Hale v. Hardon*, 89 Fed. Rep. 283, 95 Fed. Rep. 747 (C. C. A.); 1899, *Rice v. Durham Water Co.*, 91 Fed. Rep. 433; 1899, *Kurtz v. Phil., etc., R. Co.*, 187 Pa. St. 59; 1901, *Homer v. Barr Pumping Co.*, 180 Mass. 163, 91 Am. St. R. 269; 1903, *Hale v. Allinson*, 188 U. S. 56.

See, also, *infra*, *Howarth v. Angle*, 162 N. Y. 179, p. 2028.

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Sec. 694. Same. (g) Extra-territorial effect of a judgment.  
Statute of limitations.

#### GREAT WESTERN TELEGRAPH COMPANY v. PURDY.<sup>1</sup>

1896. IN THE SUPREME COURT OF THE UNITED STATES. 162 U. S.  
Rep. 329-339.

[Action by the telegraph company, an Illinois corporation, by its receiver, brought in an Iowa court, against Purdy, an Iowa stockholder of the company, to collect an amount alleged to be due upon

<sup>1</sup> Statement abridged. Arguments omitted.

his stock subscription, under a decree of the Cook County (Illinois) Court, ordering an assessment to be made upon the stockholders, in a suit in which Purdy was alleged to have been a party. The facts showed that in 1869 Purdy and other stockholders had sued in the same Illinois court to compel the company to issue shares of stock to them, to set aside as fraudulent a contract for construction of the line, to order an accounting and to hold a new election of officers. A decree to this effect was obtained, reserving to plaintiffs leave to apply for any further order necessary. In 1874 other shareholders (Purdy not being joined), by leave of court intervened and filed a "supplemental" bill, alleging mismanagement and fraud, and asking for a receiver; a decree was made appointing such receiver, and upon his report the assessment in question was ordered in 1886, and in 1888, after Purdy upon request refused to pay, this suit was brought. The lower court in Iowa gave judgment for the defendant, which was affirmed by the supreme court of Iowa on the ground that the claim was barred by the Iowa statute of limitations. Plaintiff sued out this writ of error.]

MR. JUSTICE GRAY. By article 4, section 1, of the constitution of the United States, "Full faith and credit shall be given in each state to the public acts, records and judicial proceedings of every other state. And congress may, by general laws, prescribe the manner in which such acts, records and proceedings shall be proved and the effect thereof." In the exercise of the power so conferred, congress, besides providing the manner in which the records and judicial proceedings of the courts of any state shall be authenticated, has enacted that "the said records and judicial proceedings, so authenticated, shall have such faith and credit given to them in every court within the United States, that they have by law or usage in the courts of the state from which they were taken." Act of May 26, 1790, ch. 11; 1 Stat. 122; Rev. Stat., § 905.

The plaintiff relied on the order of assessment, made by a court of the state of Illinois, as a judgment of that court, entitled to the effect of being conclusive evidence of the plaintiff's right to maintain this action against the defendant. The supreme court of the state of Iowa denied it that effect. The question whether that court thereby declined to give full faith and credit to a judicial proceeding of a court of another state, as required by the constitution and laws of the United States, was necessarily involved in the decision.

This court, therefore, has jurisdiction of the case, but must judge for itself of the true nature and effect of the order relied on. *Armstrong v. Treasurer of Athens County*, 16 Pet. 281, 285; *Texas and Pacific Railway v. Southern Pacific Co.*, 137 U. S. 48; *Grover & Baker Co. v. Radcliffe*, 137 U. S. 287; *Carpenter v. Strange*, 141 U. S. 87; *Huntington v. Attrill*, 146 U. S. 657, 666, 683, 686, and cases cited.

By the original contract between the parties, made in the state of Iowa on February 16, 1869, Purdy, the present defendant, agreed to take fifty shares, of the par value of \$25, in the plaintiff company,

and to pay five per cent. (which he did), and "the balance as the directors from time to time may order;" and the company agreed to issue the shares to him as soon as forty per cent. had been paid.

On November 19, 1869, Purdy and other subscribers for shares filed in a court of the state of Illinois a bill in equity to compel the company to issue shares to them, and to set aside as fraudulent a contract by which the company had agreed to transfer all its capital stock to one Reeve; and upon that bill, on November 16, 1872, obtained a decree setting aside that contract, and ordering shares to be issued to the subscribers as prayed for, and a new board of directors to be chosen. By that decree all the objects of the suit were accomplished so far as Purdy was concerned; and he does not appear to have any notice of or part in any further proceedings. That bill did not ask for the appointment of a receiver, or of any order of assessment upon stockholders.

The subsequent proceeding, begun September 19, 1874, alleging mismanagement and fraud of the new officers, and the insolvency of the company, was by other stockholders, and although entitled a "supplemental bill," and permitted by the court to be filed in the former cause, was a distinct proceeding, in which Purdy had and took no interest. The orders of the court upon this proceeding, appointed on October 7, 1874, a receiver, and on July 10, 1886, making a "call or assessment" upon the stockholders of the company, were entered without any notice to him, or consent on his part. He was not personally a party to this proceeding, nor named therein. The receiver was appointed almost two years, and the assessment ordered more than thirteen years after Purdy had ceased to have any connection with the litigation.

There can be no doubt that, as heretofore declared by this court, "after a decree disposing of the issues and in accordance with the prayer of a bill has been made, it is not competent for one of the parties without a service of new process or appearance, to institute further proceedings on new issues and for new objects, although connected with the subject-matter of the original litigation, by merely giving the new proceedings the title of the original cause. If this bill begins a new litigation, the parties against whom he seeks relief are entitled to notice thereof, and without it they will not be bound." *Smith v. Woolfolk*, 115 U. S. 143, 148.

The question, therefore, is of the effect as against Purdy of the order for an assessment made by the Illinois court in a proceeding to which the corporation was a party, but to which he personally was not.

The order of that court was in effect, as it was in terms, simply a "call or assessment" upon all stockholders who had not paid for their shares in full. It was such as the directors might have made before the appointment of a receiver, and in making it the court, having by that appointment assumed the charge of the assets and affairs of the corporation, took the place and exercised the office of the directors. *Scovill v. Thayer*, 105 U. S. 143, 155; *Hawkins v. Glenn*, 131 U. S.

319, 329; *Lamb v. Lamb*, 6 Bissell 420, 424; *Glenn v. Saxton*, 68 Cal. 353; *Great Western Tel. Co. v. Gray*, 122 Ill. 630, 636, 640; *Great Western Tel. Co. v. Loewenthal*, 154 Ill. 261.

The order of assessment, whether made by the directors as provided in the contract of subscription, or by the court as the successor in this respect of the directors, was doubtless, unless directly attacked and set aside by appropriate judicial proceedings, conclusive evidence of the necessity for making such an assessment, and to that extent bound every stockholder, without personal notice to him. *Hawkins v. Glenn*, 131 U. S. 319; *Glenn v. Liggett*, 135 U. S. 533; *Glenn v. Marbury*, 145 U. S. 499.

But the order was not, and did not purport to be, a judgment against any one. It did not undertake to determine the question whether any particular stockholder was or was not liable in any amount. It did not merge the cause of action of the company against any stockholder on his contract of subscription, nor deprive him of the right, when sued for an assessment, to rely on any defense which he might have to an action upon that contract.

In this action, therefore, brought by the receiver, in the name of the company, as authorized by the order of assessment, to recover the sum supposed to be due from the defendant, he had the right to plead a release, or payment, or statute of limitations, or any other defense, going to show that he was not liable upon his contract of subscription.

In each of the three cases last cited above, the defense of the statute of limitations was entertained and passed upon. *Hawkins v. Glenn*, 131 U. S. 332; *Glenn v. Liggett*, 135 U. S. 547; *Glenn v. Marbury*, 145 U. S. 506.

The whole effect of the order of assessment being to fix the amount which any stockholder liable under his contract of subscription should pay, and to authorize the receiver to bring suits against stockholders for the same, but not to determine whether the present defendant or any other particular stockholder was liable for anything, the Iowa court, by sustaining the defense of the statute of limitations, did not deny the judicial proceeding of Illinois the full faith and credit to which it was entitled.

The statute of limitations of the state of Iowa provides that "the following actions may be brought within the times herein limited, respectively, after their causes accrue, and not afterwards, except when otherwise specially declared:"

"4. Those founded on unwritten contracts, those brought for injuries to property, or for relief on the ground of fraud in cases heretofore solely cognizable in a court of chancery, and all other actions not otherwise provided for in this respect, within five years.

"5. Those founded on written contracts, on judgment of any courts, except those courts provided for in the next subdivision, and those brought for the recovery of real property, within ten years.

"6. Those founded on a judgment of a court of record, whether of

this or any other of the United States, or of the federal courts of the United States, within twenty years." Iowa Code of 1873, section 2529.

This action was not brought on a judgment, for there had been no judgment. But it was brought on the defendant's written contract of subscription, and was, therefore, by the terms of the Iowa statute, barred in ten years after the cause of action accrued. The action was brought more than ten years after the contract, but within ten years after the order of assessment.

In many jurisdictions the cause of action, within the meaning of a statute of limitations, would be held to have accrued at the time of the order for an assessment, and not before. It has been so held by the supreme court of the state of Illinois, where this company was incorporated and the order of assessment made, as well as by this court in cases coming up from circuit courts of the United States, and unaffected by decisions of the highest courts of the state in which those courts were held. *Great Western Tel. Co. v. Gray*, *Hawkins v. Glenn*, *Glenn v. Liggett* and *Glenn v. Marbury*, above cited.

But the supreme court of Iowa in the present case held that, as it rested with the directors of the corporation to make that order, the delay in making it could not suspend the operation of the statute of limitations; and that the case was within the rule, established by a series of decisions of that court, that when a plaintiff could, at any time, by making a demand or giving a notice, acquire a right to recover against the defendant, the statute of limitations began to run when he might have done so. *Great Western Tel. Co. v. Purdy*, 83 Iowa 430, 433, and cases cited.

The limitation of action is governed by the *lex fori*, and is controlled by the legislation of the state in which the action is brought as construed by the highest court of that state, even if the legislative act or the judicial construction differs from that prevailing in other jurisdictions. *M'Elmoyle v. Cohen*, 13 Pet. 312; *Bauserman v. Blunt*, 147 U. S. 647; *Metcalf v. Watertown*, 153 U. S. 671; *Balkam v. Woodstock Iron Co.*, 154 U. S. 177.

Neither the statutes nor the decisions of the state of Iowa upon this subject have made any discrimination against the citizens, the contracts or the judgments of other states, or against any right asserted under the constitution or laws of the United States. The case is thus distinguished from *Christmas v. Russell*, 5 Wall. 290, cited at the bar.

The question at what time the cause of action accrued in this case, within the meaning of the statute of limitations of Iowa, was not a federal question, but a local question, upon which the judgment of the highest court of the state can not be reviewed by this court.

*Judgment affirmed.*

*Note.* Judgment against the corporation is conclusive as to the corporate liability to the creditor but not as to the shareholder's liability to the corporation. See, 1895, *Mutual Fire Ins. Co. v. Phoenix Furniture Co.*, 108 Mich. 170, 62 Am. St. Rep. 693; 1896, *Holland v. Duluth Iron, etc., Co.*, 65 Minn. 324, 60 Am. St. Rep. 480; 1897, *Nickum v. Burckhardt*, 30 Ore. 464, 60 Am. St. Rep. 822; 1897, *Ball v. Reese*, 58 Kan. 614, 62 Am. St. Rep. 638; 1898, *Bear v. Board of Co. Com'rs*, 122 N. C. 434, 65 Am. St. Rep. 711; 1898, *Castleman*

v. Templeman, 87 Md. 546, 67 Am. St. Rep. 363; 1900, Town of Hinckley v. Kettle Riv. Co., 80 Minn. 32, 82 N. W. Rep. 1088. Compare, 1900, Ward v. Joslin, 100 Fed. Rep. 676 (C. C. N. H.), 186 U. S. 142 (*ultra vires*); 1900, Fish v. Smith, 73 Conn. 377, 84 Am. St. R. 161.

And when judgment does not bind shareholder, see, 1896, Andrews Powder Works, 76 Fed. Rep. 166, 36 L. R. A. 139; 1900, Finney v. Guy, 106 Wis. 256, 49 L. R. A. 486, 82 N. W. Rep. 595; 1902, Ward v. Joslin, 186 U. S. 142 (*ultra vires*).

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ARTICLE II. LIABILITY ARISING FROM WITHDRAWAL OF ASSETS.

Sec. 695. 1. What is a withdrawal of assets.

EDWIN A. BUCK, TRUSTEE, v. WILLIAM ROSS.<sup>1</sup>

1896. IN THE SUPREME COURT OF ERRORS OF CONNECTICUT. 68 Conn. Rep. 29-32, 57 Am. St. Rep. 60.

[Action by trustee in insolvency of a manufacturing corporation to recover the value of certain assets alleged to have been transferred to the defendant in exchange for his stock, and in fraud of the creditors of the company. Judgment in the court below for the plaintiff, and defendant alleged errors.]

ANDREWS, C. J. \* \* \* The complaint alleges that said corporation was on the 29th day of July, 1889, insolvent, and thereafter continued to be so insolvent until the date it was so declared by the court of probate, and that "the defendant, on the 14th day of June, 1890, \* \* \* well knowing the insolvency of said company, with the purpose and design of escaping financial loss and evading liability as a stockholder of said company, and in fraud of the then existing and future creditors of said company, unlawfully transferred and surrendered to said company said forty shares of the capital stock of the said company, and received in exchange therefor from said company \$4,000 in good and valuable notes and securities of said company, whereby the defendant unlawfully took from the capital of said company the sum of \$4,000, which he still retains." It is also alleged that the estate of said corporation is deeply insolvent, that said stock now in the hands of the plaintiff is wholly worthless, and that the amount so illegally withdrawn by the defendant is needed to pay the claims of creditors proved against the said insolvent estate. The plaintiff claimed to recover the value of said shares with interest.

The superior court found, in substance, that the averments of the complaint were true, and rendered judgment for the plaintiff. As to the transaction between the defendant and the said corporation on the 14th day of June, 1890, this appears:

Prior to that day the said corporation had sold to one A. G. Turner a large amount of silk manufacturing machinery, and had taken his notes therefor aggregating in the whole more than \$40,000. These notes were absolutely secured by said machinery. One of these notes

<sup>1</sup> Statement abridged; small part of opinion omitted.



for the sum of \$2,500 had been sold by the said corporation to the defendant. On said day the defendant reconveyed said \$2,500 note to the corporation, transferred to it the said forty shares of its capital stock, and gave in cash \$3,384, and received from the said corporation \$10,000 of said Turner's notes. The corporation surrendered to Turner \$10,000 of his said notes which were secured upon said machinery, and in lieu thereof Turner gave his notes for the same amount directly to the defendant, and secured these by a mortgage of other property. These notes so secured were, and are, perfectly good.

In *Crandall v. Lincoln*, 52 Conn. 73, 94, this court said: "The stock of a corporation is its only basis of credit. Unlike a partnership, its members generally are not individually liable for its debts. The character, reputation and credit of its promoters do not attach to the corporation itself, except to a limited extent. Hence it is of vital importance that the law should rigidly guard and protect the capital stock. Otherwise, especially in these days when so large a portion of the business of the country is carried on by corporations, confidence, on which the prosperity of the country largely depends, would be seriously impaired. Hence it is that in equity the capital stock of a corporation is now regarded as a trust fund for the payment of debts. The creditors have a lien upon it, which is prior in point of right to any claim which the stockholders as such can have upon it; and courts will be astute to detect and defeat any scheme or device which is calculated to withdraw this fund, or in any way to place it beyond the reach of creditors." Citing *Wood v. Dummer*, 3 Mason 308. This is the settled law. In *Cook on Stockholders*, section 312, it is said: "The objection usually made to allowing a corporation to purchase its own stock, is that thereby the corporation funds are expended and no property is received by the corporation except the right to resell. \* \* \* The better rule goes still further, and declares that if a corporation, by a purchase of shares of its own capital stock thereby reduces its actual assets below its capital stock, or if its actual assets at that time are less than the capital stock, such purchase may be impeached and set aside, and the vendor of the stock rendered liable thereon at the instance of a corporate creditor." *Morawetz on Corporations*, section 781; *Webster v. Upton*, 91 U. S. 65, 67; *Hightower v. Thornton*, 8 Ga. 486, 499.

The appellant does not dispute this rule of law. He only attempts to extricate this case from that rule. His claim is, that as the property on which Turner gave a mortgage to secure the notes he had given to the defendant was property which had never belonged to the corporation, therefore the defendant had taken nothing from the fund from which the creditors of the corporation were to be paid, and consequently ought not to be required to pay back anything. That claim is wholly inadmissible in this court. The finding of the superior court settles the facts adversely to such claim. It is found that by the said transaction and sale the defendant obtained from the corporation, in exchange for his forty shares of stock, valuable assets

of the company; and that the assets thus obtained were of the value of \$4,000. That finding is conclusive, unless inconsistent with the subordinate facts set out. Here the finding is fully supported by the facts detailed in it. The Turner notes, held by the said corporation and secured upon the machinery, were perfectly good. The Turner notes which the defendant obtained, secured upon other property, were no better. The Turner notes were the real thing which the defendant took out of the assets of the corporation. The security given for the notes, whether before or after the 14th of June, 1890, was only an incident. There is no subtlety of words which can make the incident displace the real thing, or make a shadow more important than the substance.

There is no error.

In this opinion the other judges concurred.

See, 1896, *In re Brockway Mfg. Co.*, 89 Me. 121, 56 Am. St. Rep. 401; 1899, *Heller v. National Marine Bank*, 89 Md. 602, 73 Am. St. Rep. 212. 1903, *Shields v. Hobart*, 172 Mo. 491, 95 Am. St. R. 529, 72 S. W. 669. See, also, cases following.

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Sec. 696. Same. 2. Withdrawing assets which creates insolvency.

See *Wood v. Dummer*, 3 Mason 308, *supra*, p. 1847.

*Note.* The general rule is that the corporate capital is a fund for the protection of creditors, and no part of this fund can be withdrawn by the shareholders before provision is made for the payment of creditors (*Wood v. Dummer*, *supra*; 1853, *Curran v. State of Arkansas*, 15 How. 304; 1896, *Buck v. Ross*, *supra*, p. 1977; 1896, *In re Brockway Mfg. Co.*, 89 Me. 121, 56 Am. St. Rep. 401); and such part of the funds as are improperly paid out to shareholders, so far as necessary to pay creditors, can be recovered (1898, *Grant v. Southern Contract Co.*, 20 Ky. L. Rep. 960, 47 S. W. Rep. 1091; 1899, *Davenport v. Lines*, 72 Conn. 118, *infra*, p. 1980), or from any one who is not a *bona fide* holder (1853, *Curran v. Arkansas*, 15 How. 304), in a suit in equity, but not at law (1899, *Lawrence v. Greenup*, 97 Fed. Rep. 906, *infra*, p. 1985), but it seems that if dividends are paid out of capital when the corporation is solvent, to shareholders who receive them in good faith, they can not be recovered by subsequent creditors if the corporation becomes insolvent (*McDonald v. Williams*, 174 U. S. 397, *infra*, p. 1981); neither do former losses have to be replaced, before dividends can be paid, if the corporation is solvent at the time, and the payment does not make the corporation insolvent (1899, *In re Nat'l Bk.*, 68 L. J. Ch. 634, 81 L. T. R. (N. S.) 363; 1899, *Dykman v. Keeney*, 160 N. Y. 677; but see *supra*, §§ 542, 543, 544). It seems, also, that creditors can not complain of a solvent corporation disposing of its property for an inadequate consideration (1880, *Graham v. Railroad Co.*, 102 U. S. 148, *supra*, p. 1809; 1897, *Shoemaker v. Lumber Co.*, 97 Wis. 585; 1900, *Hamilton v. Menominee F. Q. Co.*, 106 Wis. 352, 81 N. W. Rep. 876); 1903, *Shields v. Hobart*, 172 Mo. 491, 95 Am. St. R. 529, 72 S. W. 669. See also, 1900, *Hall v. Henderson*, 134 Ala. 455, 63 L. R. A. 673.

Sec. 697. Same. 3. Paying dividends after insolvency.

JOHN DAVENPORT, RECEIVER, v. GEORGE LINES.<sup>1</sup>

1899. IN THE SUPREME COURT OF ERRORS OF CONNECTICUT. 72  
Conn. Rep. 118-130.

[Action by the receiver of a corporation to recover certain sums claimed to have been illegally paid to a stockholder by way of dividends, brought in the lower court, and upon a finding of facts there, reserved for the consideration of this court. After holding that the findings of the lower court to the effect that certain patterns and scales, and the good-will of a former partnership, all inventoried at \$1,500, were not worth half that sum, there being no evidence submitted as to the value of the good-will, and also that another asset inventoried at \$2,200, representing money expended in an exhibit at the World's Fair, represented "no tangible asset," and had no value, were conclusive on this court, proceeds:]

TORRANCE, J. \* \* \* Upon the facts set forth in the record, then, the trial court has, in effect, found that the corporation, when the money here in question was paid to the defendant, was in fact insolvent and its capital stock impaired, and has expressly found that it so continued until the receiver was appointed.

The remaining question is whether the money paid to the defendant under the circumstances set forth in the record can be recovered back in this action. We think it can be. The defendant claims that he received this money in the shape of dividends which had been, in effect, regularly declared by the board of directors at a regular and lawful meeting. The record does not, perhaps, support this claim, but for the purposes of the discussion we will assume it to be true.

The general rule, even in the absence of any statute on the subject, is that dividends, in a going concern, can be properly declared and paid only out of profits, and not out of capital, or assets required for the security and payment of creditors. Morawetz on Private Corporations (1st ed.), § 344; Redfield on Railways, § 240; 2 Thompson on Corporations, § 2152. This rule applies, whether the stock upon which the dividend is declared is common stock or, as in this case, preferred stock. Warren v. King, 108 U. S. 389; Cotting v. New York & N. E. R. Co., 54 Conn. 156-169.

In addition to this our statute expressly says that "no corporation shall declare any dividend while its capital stock is impaired," and makes the officers voting in favor of such dividend, "knowing, or having the means of knowing, that such capital is impaired," liable for all losses resulting from such declaration, and their action in so voting is made a misdemeanor. General Statutes, § 1932.

The dividends here in question were declared and paid when the corporation was insolvent and its capital stock impaired, and were

<sup>1</sup> Statement abridged, and part of opinion omitted.

thus declared and paid in direct violation of these legal principles and of this statutory enactment. The money paid to the defendant in the form of dividends was wrongfully paid, to the prejudice of the creditors of the corporation, to one who was not only a stockholder of the corporation but was also a director therein from its organization until it went into the hands of the receiver. Its condition when the dividends in question were declared and paid was clearly shown upon its books, inventories and quarterly statements; and it is expressly found that the attention of the defendant was specifically called to its financial condition, as it appeared upon its books, at the very time these dividends were declared and paid. It thus appears that the defendant, when he participated in the declaration and payment of these dividends, and when he accepted them in payment, knew, or had the means of knowing, that the money really and in fact belonged to the creditors of the corporation, because it was required for the payment of their claims, and could not legally be paid away, under the form of a dividend, to one standing in his position. Under these circumstances the money paid to the defendant was part of a trust fund which belonged to the creditors of the corporation, to which he could acquire no title as against them, because he took it without consideration and with full knowledge of the trust which existed in their favor. The plaintiff in this case, as the representative of the creditors of the corporation, is entitled to sue for and recover back the money so paid. *Crandall v. Lincoln*, 52 Conn. 73; *Greene v. Sprague Mfg. Co.*, 52 Conn. 330.

The court of common pleas is advised to render judgment for the plaintiff to recover the dividends paid to the defendant, with interest from the respective dates of payment.

In this opinion the other judges concurred.

*Note. Accord:* 1898, *Grant v. Southern Contract Co.*, 20 Ky. L. Rep. 960, 47 S. W. Rep. 1091. But compare next case and, 1899, *In re National Bank*, 68 L. J. Ch. 634, 81 L. T. (N. S.) 363; 1899, *Dykman v. Keeney*, 160 N. Y. 677, 54 N. E. Rep. 1090; where it is held that paying dividends without providing for former losses, or out of capital when solvent, to shareholders who receive them in good faith, does not make such shareholders liable to subsequent creditors.

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**Sec. 698.** Same. 4. Dividends received in good faith which were paid out of capital.

**MCDONALD, RECEIVER, v. WILLIAMS.<sup>1</sup>**

**1899. IN THE SUPREME COURT OF THE UNITED STATES. 174 U. S. 397-408.**

[Action in United States Circuit Court by the receiver of a bank to recover from the defendants the amount of certain dividends alleged to have been wrongfully paid to shareholders. Judgment was given

<sup>1</sup> Statement abridged; part of opinion omitted.

for plaintiff, and an appeal taken to the United States Circuit Court of Appeals, which, upon a finding of facts, certified questions of law to this court for advice. The bank became hopelessly insolvent in 1893; shareholders have been held to the full extent of their stock liability, yet with this, and all the assets of the bank, and all the dividends ever paid, will not pay 75 per cent. of the creditors' claims. Dividends were paid from 1885 to 1892, and all those from January, 1889, to July, 1892, were declared and paid when there were no net profits—those before July, 1891, being paid out of capital while the bank was solvent, and those of 1892, out of the capital after insolvency. None of the defendants were officers or directors, and were ignorant of the bank's condition, and received the dividends in good faith, supposing them to be paid out of profits only. The questions submitted were: 1. Can the receiver recover dividends paid wholly out of capital, when the stockholder received them in good faith, believing them to be paid out of profits, and when the bank was not insolvent? 2. Has the circuit court of the United States jurisdiction to entertain a bill in equity in such case, when the objection that there is an adequate remedy at law is raised by answer?]

MR. JUSTICE PECKHAM. \* \* \* The complainant bases his right to recover in this suit upon the theory that the capital of the corporation was a trust fund for the payment of creditors entitled to a portion thereof, and having been paid in the way of dividends to the shareholders that portion can be recovered back in an action of this kind for the purpose of paying the debts of corporation. He also bases his right to recover upon the terms of section 5204 of the revised statutes.

We think the theory of a trust fund has no application to a case of this kind. When a corporation is solvent, the theory that its capital is a trust fund upon which there is any lien for the payment of its debts has in fact very little foundation. No general creditor has any lien upon the fund under such circumstances, and the right of the corporation to deal with its property is absolute so long as it does not violate its charter or the law applicable to such corporation. \* \* \*

(Citing and quoting from *Graham v. Railroad Company*, 102 U. S. 148, 161; *Hollins v. Brierfield, etc., Co.*, 150 U. S. 371, 383, 385; *Wabash, etc., R. Co. v. Ham*, 114 U. S. 587, 594.)

These cases, while not involving precisely the same question now before us, show there is no well-defined lien of creditors upon the capital of a corporation while the latter is a solvent and going concern, so as to permit creditors to question, at the time, the disposition of the property.

The bank being solvent, although it paid its dividends out of capital, did not pay them out of a trust fund. Upon the subsequent insolvency of the bank and the appointment of a receiver, an action could not be brought by the latter to recover the dividends thus paid on the theory that they were paid from a trust fund, and therefore were liable to be recovered back.

It is contended on the part of complainant, however, that if the

assets of the bank are impressed with a trust in favor of its creditors when it is insolvent, they must be impressed with the same trust when it is solvent; that the mere fact that the value of the assets of the corporation has sunk below the amount of its debts, although as yet unknown to anybody, can not possibly make a new contract between the corporation and its creditors. In case of insolvency, however, the recovery of the money paid in the ordinary way without condition is allowed, not on the ground of contract to repay, but because the money thus paid was, in equity, the money of the creditor; that it did not belong to the bank, and the bank in paying could bestow no title in the money it paid to one who did not receive it *bona fide* and for value. The assets of the bank while it is solvent may clearly not be impressed with a trust in favor of creditors, and yet that trust may be created by the very fact of the insolvency and the trust enforced by a receiver as the representative of all the creditors. But we do not wish to be understood as deciding that the doctrine of a trust fund does in truth extend to a shareholder receiving a dividend, in good faith believing it is paid out of profits, even though the bank at the time of the payment be in fact insolvent. That question is not herein presented to us, and we express no opinion in regard to it. We only say, that if such a dividend be recoverable, it would be on the principle of a trust fund.

Insolvency is a most important and material fact, not only with individuals but with corporations, and with the latter, as with the former, the mere fact of its existence may change radically and materially its rights and obligations. Where there is no statute providing what particular act shall be evidence of insolvency or bankruptcy, it may be, and it sometimes is, quite difficult to determine the fact of its existence at any particular period of time. Although no trust exists while the corporation is solvent, the fact which creates the trust is the insolvency, and when that fact is established, at that instant the trust arises. To prove the instant of creation may be almost impossible, and yet its existence at some time may very easily be proved. What the precise nature and extent of the trust is, even in such case, may be somewhat difficult to accurately define, but it may be admitted in some form and to some extent to exist in a case of insolvency.

Hence it must be admitted that the law does create a distinction between solvency and insolvency, and that from the moment when the latter condition is established the legality of acts thereafter performed will be decided by very different principles than in a case of solvency. And so of acts committed in contemplation of insolvency. The fact of insolvency must be proved in order to show the act was one committed in contemplation thereof.

Without reference to the statute, therefore, we think the right to recover the dividend paid while the bank was solvent would not exist.

But it is urged on the part of the complainant that section 5204 of the Revised Statutes makes the payment of a dividend out of capital illegal and *ultra vires* of the corporation, and that money thus paid



remains the property of the corporation, and can be followed into the hands of any volunteer.

The section provides that "no association, or any member thereof, shall, during the time it shall continue its banking operations, withdraw, or permit to be withdrawn, either in the form of dividends or otherwise, any portion of its capital." What is meant by this language? Has a shareholder withdrawn, or permitted to be withdrawn, in the form of a dividend, any portion of the capital of the bank when he has simply and in good faith received a dividend declared by a board of directors of which he was not a member, and which dividend he honestly supposed was declared only out of profits? Does he in such case, within the meaning of the statute, withdraw or permit to be withdrawn a portion of the capital? The law prohibits the making of a dividend by a national bank from its capital or to an amount greater than its net profits then on hand, deducting therefrom its losses and bad debts. The fact of the declaration of a dividend is in effect the assertion by the board of directors that the dividend is made out of profits. Believing that the dividend is thus made, the shareholder in good faith receives his portion of it. Can it be said that in thus doing he withdraws or permits to be withdrawn any portion of the capital of the corporation? We think he does not withdraw it by the mere reception of his proportionate part of the dividend. The withdrawal was initiated by the declaration of the dividend by the board of directors, and was consummated on their part when they permitted payment to be made in accordance with the declaration. We think this language implies some positive or affirmative act on the part of the shareholder by which he knowingly withdraws the capital or some portion thereof, or with knowledge permits some act which results in the withdrawal, and which might not have been so withdrawn without his action. The permitting to be withdrawn can not be founded upon the simple receipt of a dividend under the facts stated above.

One is not usually said to permit an act which he is wholly ignorant of, nor would he be said to consent to an act of the commission of which he had no knowledge. Ought it to be said that he withdraws or permits the withdrawal by ignorantly yet in entire good faith receiving his proportionate part of the dividend? Is each shareholder an absolute insurer that dividends are paid out of profits? Must he employ experts to examine the books of the bank previous to receiving each dividend? Few shareholders could make such examination themselves. The shareholder takes the fact that a dividend has been declared as an assurance that it was declared out of profits and not out of capital, because he knows that the statute prohibits any declaration of a dividend out of capital. Knowing that a dividend from capital would be illegal, he would receive the dividend as an assurance that the bank was in a prosperous condition and with unimpaired capital. Under such circumstances we can not think that congress intended by the use of the expression "withdraw or permit to be withdrawn, either in the form of dividends, or otherwise," any portion of its capital, to include the case of the passive receipt of a divi-

dend by a shareholder in the *bona fide* belief that the dividend was paid out of profits, while the bank was in fact solvent. We think it would be an improper construction of the language of the statute to hold that it covers such a case. \* \* \*

We may concede that the directors who declared the dividend under such circumstances violated the law, and that their act was therefore illegal, but the reception of the dividend by the shareholder in good faith, as mentioned in the question, was not a wrongful or designedly improper act. Hence the liability of the shareholder should not be enlarged by reason of the conduct of the directors. They may have rendered themselves liable to prosecution, but the liability of the shareholder is different in such a case, and the receipt of a dividend under the circumstances is different from an act which may be said to be generally illegal, such as the purchase of stock in one national bank by another national bank for an investment merely, which is never proper. *Concord First National Bank v. Hawkins*, just decided, 174 U. S. 364. \* \* \* (We answer the first question in the negative, and it becomes unnecessary to answer the second question.)

*Accord*: 1899, *In re Nat'l Bk. of Wales*, 68 L. J. Ch. 634, 81 L. T. R. (N. S.) 363; 1899, *Dykman v. Keeney*, 160 N. Y. 677, 54 N. E. Rep. 1090. But see preceding case.

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**Sec. 699. Same. 5. Remedy only in equity, not at law.**

LURTON, CIRCUIT JUDGE, IN *LAWRENCE v. GREENUP*.

1899. IN THE UNITED STATES CIRCUIT COURT OF APPEALS, MICHIGAN. 97 Fed. Rep. 906, on 910, 911.

[Action at law by the receiver of a national bank to recover of Greenup a dividend of 50 per cent. of his \$2,000 of stock in the bank, paid in good faith to him by the directors of the bank, and by him received in good faith, out of the capital of the bank, while it was, and which left it solvent, and while it was in the process of voluntary liquidation for the purpose of consolidation or merger with the Mecosta Savings Bank. Afterwards other dividends were paid to other parties, but not to Greenup, which had the effect with certain claims of the savings bank which arose upon contracts made after the bank went into liquidation, to make the latter insolvent.] \* \* \*

We express no opinion as to the effect of a fraudulent distribution of the assets of a corporation with the purpose of defeating its creditors; nor need we deal with the question of the legal right of the receiver to maintain this suit if the dividend had been paid or received in bad faith, or for a dividend paid and received in violation of section 5204, revised statutes, as in *Finn v. Brown*, 142 U. S. 56, 12 Sup. Ct. 136. The dividend sued for here was both paid and received in good faith, both the directors who declared it and the stockholders here sued be-

believing that the bank was solvent, the assets being such as to justify this dividend. Neither is it shown that the payment of the 50 per cent. dividend was made when the bank was in fact insolvent, or that the payment reduced the bank to a condition of insolvency. Subsequently other dividends were paid, in which the defendant in error did not participate.

From the showing of assets now on hand, and debts yet unpaid, it is indeed plain and obvious that the distribution made through the original 50 per cent. dividend of November, 1895, did not reduce the bank to its present probable condition of insolvency. The subsequent dividends are alone responsible for the present condition. The fact that this bank was in liquidation does not materially affect the situation. The corporation was still in absolute control of its assets, and its power of disposition was unaffected. Those in charge of the liquidation were charged with the duty of winding up the affairs of the bank, and applying the proceeds, first, to the payment of debts, and, second, to the distribution of the remainder among the shareholders. If the bank was not insolvent when this dividend was declared or paid, and the division of a portion of the assets did not reduce the bank to a condition of insolvency, on what theory can it be maintained that the bank, or a receiver subsequently appointed, could maintain an action at common law upon implied promises to return the dividend so paid and received? The distinction between this case and that of *McDonald v. Williams*,<sup>1</sup> cited above, is that the dividend was confessedly paid out of capital, and received with knowledge of that fact. But in the case referred to the bank was a going concern, and prohibited by section 5204, revised statutes, from withdrawing any part of its capital for the purpose of paying dividends while it should "continue its banking operations." The directors who declared the dividend out of capital were said by the court to have rendered themselves liable under the statute, but the stockholder who received it was acquitted from liability to return same, though in fact paid out of capital, and though the bank subsequently became insolvent, because he did not receive it knowing that it was paid in violation of the statute. Section 5204 has no application here, because this bank was not engaged in its ordinary banking operations, and was in voluntary liquidation. If this dividend was paid in good faith at a time when the assets were abundantly sufficient to justify such a return of capital without depriving existing creditors of a fund ample to pay their dividends, it is difficult, under the doctrine of the cases we have cited, to see any ground upon which the stockholders can be made to refund. \* \* \*

The considerations we have mentioned lead us to the conclusion that the plaintiff in error can not, in an action at law, recover dividends paid by a liquidating bank which was solvent when the dividend was declared and paid, although paid wholly out of capital, if paid and received in the honest belief that the assets justified such payment. The case of *McDonald v. Williams*, and the cases preceding that, leave no room to doubt but that in the absence of fraud, or bad faith, equivalent to fraud, the condition of trust neces-

<sup>1</sup> 174 U. S. 397, *supra*, p. 1981.

sary to give a corporate creditor, or a receiver representing both the corporation and creditors, the right to follow and compel the return of the dividends paid out of capital, depends upon, and arises out of, an established insolvency. The right when insolvency is shown to have existed is an equitable right, and will not support a purely legal action. If we assume, therefore, that insolvency existed in fact when this dividend was paid, the remedy—there being no fraud or bad faith—where it is sought to compel the return of such dividend, is in equity and not at law.

*Note:* See *supra*, § 688, and note; also, *infra*, § 715 and note.

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### C. STATUTORY LIABILITY OF SHAREHOLDERS.

#### ARTICLE I. GENERAL CHARACTERISTICS.

#### Sec. 700. I. Kinds: Contractual and penal.

ALFRED H. WILES ET AL., RESPONDENTS, v. LAMBERT SUYDAM,  
APPELLANT.<sup>1</sup>

1876. IN THE COURT OF APPEALS OF NEW YORK. 64 N. Y. Rep.  
173-179.

[Appeal from general term, overruling a demurrer to plaintiff's complaint.]

CHURCH, C. J. The ground of demurrer relied upon is that several causes of action are improperly united. The complaint contains but one count composed of a series of allegations, and was doubtless framed upon the theory that there is but one cause of action contained. If, however, the complaint does contain several causes of action, and they are improperly united, the omission to state the causes of action in separate counts properly numbered does not deprive the defendant of the right to demur. (*Goldberg v. Utley*, 60 N. Y. 427.) The complaint alleges an indebtedness against the Imperishable Stone Block Pavement Company of New York City, which had been prosecuted to judgment and execution; that the defendant was a "stockholder to the amount of \$50,000," but had not paid for the same, and that no certificate had been made and recorded that the capital was paid in. Section 10 of the act authorizing the formation of corporations for manufacturing and other purposes declares that until such certificate is recorded the stockholders shall be liable for the debts of the company to the amount of their stock respectively. The complaint also alleges that at the time the debt was contracted, and ever since, the defendant was a trustee of the corporation, and that no report was filed on the 1st day of January, 1873, nor at any time since, and for this neglect the twelfth section of the act aforesaid de-

<sup>1</sup> Statement, except as given in the opinion, and part of the opinion omitted.

clares that the trustees shall be liable for all the debts of the corporation then existing, or which may be thereafter created, until such report is filed.

It is insisted by the counsel for the plaintiff that this constitutes but one cause of action, and he argues that the cause of action is to recover the debt upon two grounds of personal liability created by statute. I am unable to concur in this view. The recovery of the debt is the object of the action, but a cause of action must have two factors—the right of the plaintiff and the wrong or obligation of the defendant. These must concur to give a cause of action. The cause of action against the defendant as a stockholder consists of the debt and the liability created by statute against stockholders when the stock has not been paid in and a certificate of that fact recorded. In effect, the statute in such a case withdraws the protection of the corporation from the stockholders, and regards them liable to the extent of the amount of their stock as copartners. (*Corning v. McCullough*, 1 N. Y. 47.) The allegations in the complaint are sufficient to establish a perfect cause of action against the defendant as a stockholder primarily liable for the debts to the amount of his stock. The allegations against the defendant as trustee also constitute a distinct and perfect cause of action, but of an entirely different character. Here the liability is created by statute and is in the nature of a penalty imposed for neglect of duty in not filing a report showing the situation of the company. The object of the action is the same, viz., the collection of the debt; but the liability and the grounds of it are entirely distinct and unlike. That there are two causes of action in this complaint seems too clear to require much argument. The more difficult question is, whether they may be united in the same complaint. The first cause of action against the defendant as a stockholder is an action on contract. The six years' statute of limitations applies. (1 N. Y., *supra*.) The defendant is entitled to contribution. (3 Hill 188.) But in respect to the action against defendant as trustee, this court held, in *Merchants' Bank v. Bliss* (35 N. Y. 412), that the three years' statute of limitations applied under the following provisions of the code: "An action upon a statute for penalty or forfeiture when the action is given to the party aggrieved." (§ 92.)

With this decision before us, which we do not feel at liberty to overrule, this cause of action must be regarded as an action *upon a statute for a penalty or forfeiture*. The liability is far more extensive than that of stockholder, it is for all debts, while the former is limited to the amount of the stock. The defendant would not be entitled to contribution except by statute (Laws of 1871, p. 1435), and contributions would be from different persons than in the other case. It is claimed also that execution against the person might issue and this would seem to follow from the decision in 1 New York (*supra*), but we do not deem it necessary to pass upon that question. If these actions may be united it must be by virtue of the first subdivision of section 167 of the code. From the nature of the two actions they do not come under either of the other subdivisions. The first subdivis-

ion reads as follows: "The plaintiff may unite in the same complaint several causes of action whether they be such as have been heretofore denominated legal or equitable, or both, when they all arise out of: 1st. The same transaction or transactions connected with the same subject of action." This language is very general and very indefinite. I have examined the various authorities upon this clause, and I am satisfied that it is impracticable to lay down a general rule which will serve as an accurate guide for future cases. It is safer for courts to pass upon the question as each case is presented. \* \* \*

In this case it is attempted to unite an action on a statute for a penalty with an action on contract. The nature of the two actions are essentially different, although the object to be attained is the same. The facts to establish the liability are entirely unlike. The measure of liability is different. The defenses are different. The rights of the defendant may be seriously prejudiced. Suppose a general verdict is obtained, from whom would the defendant seek contribution, from his cotrustees or from his costockholders? Can it be said that these causes of action arose out of the same transaction? If so, what was the transaction? Was it the formation of the company? That created no liability nor cause of action. Was it the debt of the plaintiff? That created no liability against the trustees, nor does such liability arise out of it. Was it the failure to file a certificate that the stock was not paid in? If so, there is no connection between that and the transaction which created the liability against the defendant as trustee. An omission to record a certificate that the stock was paid is not, in any sense, the same transaction as the neglect of trustees to file a report of the financial condition of the company. Without attempting to define the terms of the last clause, I do not think that there is any such connection between the transactions, out of which the causes of action arose in this case, and the "subject of action."

\* \* \*

*Reversed.* All concur.

*Note.* 1. As to what is *contractual* liability, see, 1883, *Flash v. Conn*, 109 U. S. 371; 1890, *Cochran v. Wiechers*, 119 N. Y. 399; 1892, *Willis v. Mabon*, 48 Minn. 140, 31 Am. St. Rep. 626, *infra*, p. 2013; 1892, *Huntington v. Attrill*, L. R. 18 App. Cas. 150, 146 U. S. 657, *supra*, p. 1892; 1894, *Hencke v. Twomey*, 58 Minn. 550; 1895, *Mandel v. Swan, etc., Cattle Co.*, 154 Ill. 177, 45 Am. St. Rep. 124, note 132; 1898, *Bell v. Farwell*, 176 Ill. 489, 42 L. R. A. 804; 1898, *Parker v. Carolina Sav. Bk.*, 53 S. C. 583, 69 Am. St. Rep. 888; 1899, *First Nat'l Bk. v. Weidenbeck*, 97 Fed. Rep. 896; 1900, *Davis v. Mills*, 99 Fed. Rep. 39; 1900, *Whitman v. Oxford Nat'l Bk.*, 176 U. S. 559; *infra*, p. 2018; 1900, *Hancock Nat'l Bk. v. Farnum*, 176 U. S. 640; 1900, *Howarth v. Angle*, 162 N. Y. 179, 47 L. R. A. 725, *infra*, p. 2028; 1900, *Woodworth v. Bowles*, 61 Kan. 569, 60 Pac. Rep. 331, *infra*, p. 2014. See, also, *infra*, §§ 701-703, 705-714.

2. As to what is *penal*, see, 1858, *Derrickson v. Smith*, 27 N. J. L. 166 (failure to file report); 1882, *Diversey v. Smith*, 103 Ill. 378; 1884, *Webb P. & F. M. Co. v. Beecher*, 97 N. Y. 651; 1884, *Stokes v. Stickney*, 96 N. Y. 323; 1889, *Attrill v. Huntington*, 70 Md. 191, 14 Am. St. Rep. 344, note 350; 1890, *Carr v. Rischer*, 119 N. Y. 117; 1896, *State Sav. Bk. v. Johnson*, 18 Mont. 440, 56 Am. St. Rep. 591; 1899, *Crippen v. Loughton*, 69 N. H. 540, 46 L. R. A. 467, 44 Atl. Rep. 538.



Sec. 701. Same. 2. General nature of contractual statutory liability.

ELIJAH UMSTED v. HENRY A. BUSKIRK ET AL.

1866. IN THE SUPREME COURT OF OHIO. 17 Ohio St. Rep. 113-118.

WHITE, J. The original petition in this case is in the nature of a bill in equity, and is filed by a judgment creditor of an insolvent corporation to obtain satisfaction of his judgment by the enforcement of the statutory liability of the several stockholders, and of the liability of one of them on an unpaid stock subscription.

No objection is made on the ground of a defect of parties; and, for aught that appears in the record, the plaintiff is the only creditor and the defendants the only stockholders of the corporation.

The only ground assigned for the demurrer is that the petition does not contain facts sufficient to constitute a cause of action.

The corporation of which the defendants are stockholders was organized under the act of May 1, 1852, and the liability of the stockholders in question is provided for in section seventy-eight, which, as originally passed, is as follows:

"All stockholders of any railroad, turnpike, or plankroad, magnetic telegraph, or bridge company, shall be deemed and held liable to an amount equal to their stock subscribed, in addition to said stock, for the purpose of securing the creditors of such company." O. L., vol. 50, p. 296, 3 Curwen's Stat. 1897.

The subsequent amendment of April 17, 1854, did not alter the section in respect to railroad companies. 1 S. & C. Stat. 310, 4 Curwen's Stat. 2582.

The counsel of the defendant in error claims to support the judgment below, on the ground that it was not the intention of the legislature "to make the stockholders in the railroad companies *individually liable to the creditors of the company*," but that as stockholders they are subject to be assessed *pro rata* by the corporation, to the extent of this statutory liability.

This claim was made in *Wright et al. v. McCormack et al.* (decided at the present term, 17 Ohio St. 86), and overruled. It was held in that case that this liability of the stockholders was a security provided by law for the exclusive benefit of the creditors, over which the corporate authorities had no control.

If the corporation has the right to enforce this liability by assessments, it can exhaust it to discharge a present indebtedness, and continue its business with no other security to its future creditors than its corporate liability.

This would neither be in accordance with the design of the constitutional provision, nor of the statute. The intention, doubtless, was to provide an ultimate security to which the creditors might resort on the failure and insolvency of the corporation.

Nor will it follow as counsel suppose from the denial of the right to the corporation of enforcing this liability, that it may be enforced against part of the stockholders at the election of the creditor, without the right on their part to call on their costockholders for contribution.

The liability on the part of the stockholders is several in its nature, but the right arising out of this liability is intended for the common and equal benefit of all the creditors. The suit of a creditor under this statute should, in our opinion, be for the benefit of all the creditors; and the stockholders whose liability is sought to be enforced have the right to insist on their costockholders being made parties for the purposes of a general account, and to enforce from them contribution in proportion to their shares of stock.

The right of contribution grows out of the organic relation existing among the stockholders. As between them and the creditors, each stockholder is severally liable to all the creditors; as between themselves, each stockholder is bound to pay in proportion to his stock.

The corporation ought to have been made a party, but the omission was not made an objection, and the demurrer was sustained and the action dismissed on the sole ground of the petition not showing a cause of action against the defendants.

The omission to make the corporation a party is, therefore, no objection to the reversal of the judgment.

The judgment sustaining the demurrer and dismissing the action is reversed and the cause remanded for further proceedings.

Day, C. J., and Welch, Brinkerhoff and Scott, JJ., concurred.

*Note.* See, also, *Zang v. Wyant*, 25 Colo. 551, 71 Am. St. Rep. 145, *infra*, p. 2025; 1898, *Parker v. Carolina Sav. Bk.*, 53 S. C. 583, 69 Am. St. Rep. 888.

1. The contractual liability survives the death of the shareholder, and is enforceable against his estate (1890, *Cochran v. Wiechers*, 119 N. Y. 399); is enforceable in other states, unless some peculiar special remedy is provided (see *Whitman v. Oxford Nat'l Bk.*, 176 U. S. 559, *infra*, p. 2018; *Marshall v. Sherman*, 148 N. Y. 9, *infra*, p. 2021; *Howarth v. Angle*, 162 N. Y. 179, *infra*, p. 2028); can be imposed by the state only by consent of the shareholder (1869, *Ireland v. Palestine Tp. Co.*, 19 Ohio St. 369, *supra*, p. 757); unless there is a reserved power to amend, in which case the state can impose without consent of shareholders (1886, *Sleeper v. Goodwin*, 67 Wis. 577; 1894, *Bissell v. Heath*, 98 Mich. 472; 1896, *McGowan v. McDonald*, 111 Cal. 57, 52 Am. St. Rep. 149; 1900, *Williams v. Nall*, 21 Ky. L. Rep. 1526, 55 S. W. Rep. 706); and such a liability when once imposed can not be repealed so as to impair the security of existing creditors (1864, *Hawthorne v. Calef*, 2 Wall. 10, *supra*, p. 752; 1900, *Woodworth v. Bowles*, 61 Kan. 569, 60 Pac. Rep. 331, *infra*, p. 2014). It may be waived by the creditor (1883, *Brown v. Eastern Slate Co.*, 134 Mass. 590); those who pay more than their share can have contribution from others that are also liable (1895, *Brown v. Merrill*, 107 Cal. 446, 48 Am. Rep. 145; 1898, *Myers v. Sierra Val. S. & A. Assn.*, 122 Cal. 669, 55 Pac. Rep. St. 689; *Bennison v. McConnell*, 56 Neb. 46, 76 N. W. Rep. 412, *supra*, p. 1771; 1900, *Moxham v. Grant*, 69 L. T. Q. B. 97, 81 L. T. (N. S.) 431, *supra*, p. 1794; but compare, 1899, *Sacramento Bank v. Pacific Bank*, 124 Cal. 147, 71 Am. St. Rep. 36, note, p. 40).

2. *Set-off.* If the statutory liability is primary (and perhaps in some cases, if secondary), the shareholder may set off a debt due him by the corporation, against his liability. See, 1876, *Boyd v. Hall*, 56 Ga. 563; 1889, *Boulton Car-*

bon Co. v. Mills, 78 Iowa 460, 5 L. R. A. 649; 1896, Hood v. French, 37 Fla. 117; 1900, Ball v. Anderson, 196 Pa. St. 86; 1900, Broadway Nat'l Bk. v. Baker, 176 Mass. 294.

*Contra*: 1899, Lauraglen Mills v. Ruff, 57 S. C. 53, 49 L. R. A. 448.

Sec. 702. Same. 3. To what it applies; interpretation; debts.

CYRIL C. CHILD v. BOSTON AND FAIRHAVEN IRON WORKS ET AL.<sup>1</sup>

1884. IN THE SUPREME JUDICIAL COURT OF MASSACHUSETTS.  
137 Mass. Rep. 516-523.

[Bill in equity by Child, on behalf of himself and all the other creditors, against the corporation and its officers to enforce their statutory liability, alleging that he had obtained a judgment for \$5,640 damages and \$1,778 as costs against the defendant corporation for an infringement of patents belonging to plaintiff; also, that the debts exceeded the capital stock by \$9,000, and that the officers had knowingly filed false certificates of the assets and liabilities of the corporation. The defendants demurred to the bill on the ground that the statutory liability did not extend to claims arising from infringement of patents. The statute provided, "The officers of any corporation shall be jointly and severally liable for its debts and contracts, when the debts exceed the capital to the extent of such excess, and for signing any certificate required by law, knowing it to be false." Section 38, Laws of 1870.]

FIELD, J. \* \* \* (After reviewing the former legislation.) Whatever reason once existed for giving a liberal construction to the word "debt" in the earlier statutes, on the ground that a stockholder in every manufacturing corporation was liable to have his property taken to satisfy any judgment in any civil suit against the corporation, has now ceased to exist, when the stockholders and officers are only liable under special provisions of statute.

The word "debts," and the words "debts and contracts," do not in their legal sense ordinarily include liabilities for torts not reduced to a judgment. There is nothing in the statutes indicating that, for causes stated, the officers were to be made responsible for all the liabilities of the corporation. Gray v. Bennett, 3 Met. 522; Chase v. Ingalls, 97 Mass. 524; Lowell v. Street Commissioners, 106 Mass. 540; Zimmer v. Schleeauf, 115 Mass. 52; Heacock v. Sherman, 14 Wend. 58; Esmond v. Bullard, 16 Hun 65; Archer v. Rose, 3 Brewst. 264; Cable v. McCune, 26 Mo. 371; Dryden v. Kellogg, 2 Mo. App. 87; Bohn v. Brown, 33 Mich. 257, 263.

It was said by Chief Justice Shaw, in Gray v. Coffin, 9 Cush. 192, 199, that "to create any individual liability of members for the debt of a corporation, a body politic, created by law, and regarded as a legal being, distinct from that of all the members composing it, and capa-

<sup>1</sup> Statement much abridged; part of opinion omitted.

ble of contracting and being contracted with as a person, is a wide departure from established rules of law, founded in considerations of public policy, and depending solely upon provisions of positive law. It is, therefore, to be construed strictly, and not extended beyond the limits to which it is plainly carried by such provisions of statute."

In *Mill Dam Foundry v. Hovey*, 21 Pick. 417, 455, a case arising under the statute of 1829, c. 53, Chief Justice Shaw said:

"For, though a question was made whether such a claim for unliquidated damages is a debt, within the meaning of the statute, we do not think it admits of a reasonable doubt that all such claims for damages were intended to be included in the term 'debts.'" The claim there was of unliquidated damages for the breach of a contract by the corporation. See, also, *Byers v. Franklin Coal Co.*, 106 Mass. 131; *Hawes v. Anglo-Saxon Petroleum Co.*, 101 Mass. 385.

In *Carver v. Braintree Manuf. Co.*, 2 Story 432, one Edson was excluded as a witness on the ground that he was interested in the event of the suit. The action was case for the infringement of a patent. The defendant was created a corporation by the statutes of 1823, c. 45, and was made subject to the statutes of 1808, c. 65, and the several acts in addition thereto. Edson was a stockholder at the time of the alleged infringement, although it seems that he had sold out his stock before the action was brought. Mr. Justice Story said: "I follow out the doctrine of the case of *Mill Dam Foundry v. Hovey*, 21 Pick. 455, which, as far as it goes, disclaims the interpretation of the word debt, as limited to contracts for the payment of determinate sums of money. Passing that line, it does not seem to me easy to say that if cases of unliquidated damages may be treated as debts, because they end in the ascertainment of a fixed sum of money, that we are at liberty to say that the doctrine is not equally applicable to all cases of unliquidated damages, whether arising *ex contractu* or *ex delicto*. If ultimately it ends in a debt, as a judgment for damages does, that case asserts that its character as a debt relates back to its origin. Besides, it seems to me upon principle to be reasonable, if not absolutely justified by authority, to hold that if the transaction occurs while a person is a member of the corporation, and he would, if he remained a member, be liable for the ultimate debt adjudged, it may well be treated as an inchoate debt consummated by the judgment." 2 Story 451.

This case was cited in *Wyman v. American Powder Co.*, 8 Cush. 168, 182, which was an action of assumpsit, and independently of the form of it, the cause of action was essentially *ex contractu*.

There are no cases decided by the courts of the commonwealth in which a stockholder has been held liable for a tort of the corporation, and the decision of Mr. Justice Story stands unsupported by any direct authority, either before or since. \* \* \*

The debts and contracts of a corporation may not be the debts and contracts of individuals, because the corporation is a legal person and can contract. If the corporation is worthless, the creditor may have no effectual remedy, and, therefore, in the cases specified the statute

has given an additional remedy. In this respect the statute was enacted apparently for the protection of persons who deal with the corporation. But the torts of a corporation are also the torts of natural persons, because the corporation can only act by means of persons, and these persons are liable as well as the corporation. There are, indeed, torts arising from contracts for which either case or assumpsit is the proper form of action, but the action in either form is essentially an act for the breach of a contract, express or implied. Liability for wrongs done which are independent of contracts can not, we think, be considered a debt or contract within the meaning of the statute. Whether, if a judgment is recovered in an action of tort, it then becomes a debt of record within the meaning of the statute, we have no occasion to consider, because there is no allegation that any of the personal defendants were officers of the corporation, or did any of the acts alleged at or after the time when the final decree against the corporation was entered. See *Curtis v. Harlow*, 12 Met. 3. \* \* \*

We think that the decree which the plaintiff has obtained against the defendant corporation is, in legal effect, a judgment for all the damages done him by the infringement of his patent, which was a tort not arising from any contract, and that the liability therefor, before the decree was obtained, was not a "debt" or "contract" within the meaning of the statute of 1870, ch. 224, § 38.

*Bill dismissed.*

*Note.* See, 1852, *Gray v. Coffin*, 9 Cush. 192, 199. Compare next case.

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### Sec. 703. Same.

#### RIDER V. FRITCHEY, ADMINISTRATOR.<sup>1</sup>

1892. IN THE SUPREME COURT OF OHIO. 49 Ohio St. Rep. 285-296.

[Action by Fritchey, a judgment creditor of an insolvent street railroad company, the judgment being for over \$1,200, for causing the death of plaintiff's intestate through negligence, against Rider and the other shareholders, and on behalf of himself and the other creditors, to enforce the statutory liability of the shareholders; the court below found the names of all the creditors, and the amounts due them, the names of the shareholders, with amount of stock held by them, and levied an assessment of about 50 per cent. to pay all claims, including the plaintiff's—Rider's proportion of all being \$1,269. Error was prosecuted to the circuit court on the ground that the statutory liability was incident only to claims arising out of contracts. The circuit court affirmed the decision of the common pleas court.]

SPEAR, C. J. \* \* \* A more serious question arises with respect to the second point: Can the stockholders of an Ohio corporation be held

<sup>1</sup> Statement abridged, part of opinion omitted.

for obligations of the corporation growing out of its torts? It follows from what has already been stated, that we must assume that this street railroad company was organized under a law which imposed upon stockholders just such liability as the constitutional provision requires. We look, therefore, to the constitution as our guide. The provision, section 3, of article 13, is : "Dues from corporations shall be secured by such individual liability of the stockholders and other means as may be prescribed by law ; but in all cases, each stockholder shall be liable, over and above the stock by him or her owned, and any amount unpaid thereon, to a further sum, at least equal in amount to such stock." The question turns upon the import of the word "dues."

It has been contended that provisions creating individual liability on the part of the stockholders are in derogation of the common law, and are, therefore, to be construed strictly. Authorities in support of this rule are not wanting, and, in so far as such liability is attached by way of penalty for the omission of some act required by the statute, as in some of the states, it is probable that the weight of authority favors the proposition. But all concede that this is a remedial provision, and to hold that there must be applied to it the same test as if it were a penal law, is to hold that all remedial laws must be so construed, for every remedial law must of necessity be in derogation of the common law. Where the provision is simply remedial, though it does impose an obligation which will not attach at common law, we see no reason to insist upon what is called a strict construction, but believe that the ordinary rule which requires the court to inquire simply as to the intent of the law-makers, reading the provisions as they were intended to be read, will best attain the ends of justice. This leads us to look to the intent of the section quoted. Speaking in general terms, it must be manifest that the intent was to provide that those who derive advantage from the authority of the state, given by our incorporation laws, shall at the same time assume responsibility for the acts of the artificial creature which they have called into legal being affecting the rights of others. Having in mind this general intent, and the provision being remedial, it should, we think, be construed with a view to remove the evil and extend the benefit proposed.

It is conceded that if a cause of action for a tort can be treated as a "debt," the liability of the stockholders for it would follow. The affirmative of this is asserted, and the following authorities are cited in its support: *Carver v. Manufacturing Company*, 2 Story 432; *Milldam Foundry v. Hovey*, 21 Pick. 417; *Gray v. Bennett*, 3 Met. 522; *Smith v. Omans*, 17 Wis. 406, and *White v. Hunt*, 6 N. J. L. 402. To the contrary of this, counsel for plaintiff in error cite: *Bohn v. Brown*, 33 Mich. 257; *Cable v. McCune*, 26 Mo. 371; *Doolittle v. Marsh*, 11 Neb. 243; *Heacock v. Sherman*, 14 Wend. 59; *Archer v. Rose*, 3 Brewster 264; *Child v. Iron Works*, 137 Mass. 516; *Cook Stock and Stockholders*, § 220; *Morawetz*, §§ 608, 613; *Nanson v. Jacobs (Mo.)*, 6 S. W. Rep. 246; *Evans v. Lewis*, 30 Ohio St. 11; *Crouch v. Gridley*, 6 Hill 250; *Kellogg v. Schuyler*, 2



Denio 73, and *Zimmer v. Schleeauf*, 115 Mass. 52. A review of these authorities would be important if a holding upon the proposition were necessary to a decision of the case before us. We think it is not.

It would seem to be the undoubted duty of the court to give the word "dues," as found in the section quoted, such construction as will secure the apparent object of the constitution-makers in its adoption. Constitutions are necessarily couched in terse language, and we look there for the use of words in a broad, comprehensive sense. This term "dues" is of extended import. Among other definitions Latham gives the singular: owed; capable of being justly demanded; that which may be justly claimed. Worcester: that which anyone has a right to demand. Webster: that ought to be paid or done to or for another; justly claimed as a right or property; fulfilling obligation; that which belongs to or may be claimed as a right; whatever custom, law, or morality requires to be done; right, just title or claim. Bouvier defines it as what ought to be paid; what may be demanded. It seems natural to say that where one is injured by the negligence of another, reparation is due. This implies a legal demand for reparation, and in *Heacock v. Sherman*, *supra*, Justice Nelson admits that the word "demand" found in the New York statute, if it stood alone, would be broad enough to include a cause of action for a tort. \* \* \*

As conclusion, we are of the opinion that the word "dues" should receive a beneficial construction, one which will include within its scope as well a demand for unliquidated damages for a tort as a claim for a debt arising upon contract.

Affirmed.

*Note.* See preceding case.

*Note.* *As to debts and dues:* See further: 1898, *Brown v. Trail*, 89 Fed. Rep. 641; 1900, *Ward v. Joslin*, 100 Fed. Rep. (C. C. N. H.) 676.

#### Sec. 704. Same. 4. General nature of penal liability.

See *Huntington v. Attrill*, 146 U. S. 657, *supra*, p. 1892; *Wiles v. Suydam*, 64 N. Y. 173, *supra*, p. 1987.

*Note.* See note, *supra*, pp. 1892, 1991.

Penal liability does not survive death of the party liable when judgment has not been obtained (1884, *Stokes v. Stickney*, 96 N. Y. 323); but if judgment has been obtained it survives (1890, *Carr v. Rischer*, 119 N. Y. 117); it attaches to the directors at the time of default (1880, *Bruce v. Platt*, 80 N. Y. 379); is not enforceable in another state if it is a true penalty (1889, *Attrill v. Huntington*, 70 Md. 191, 14 Am. St. Rep. 344, note 350; 1899, *Crippen v. Loughton*, 69 N. H. 540, 46 L. R. A. 467, 44 Atl. Rep. 538); can be repealed by the state at any time, for a creditor has no vested right in a penalty (1884, *Webb P. & F. M. Co. v. Beecher*, 97 N. Y. 651); and perhaps there can be no contribution in case one pays more than his share (1889, *Sayles v. Brown*, 40 Fed. Rep. 8; 1899, *Sacramento Bk. v. Pacific Bk.*, 124 Cal. 147, 71 Am. St. Rep. 36; but compare, 1895, *Brown v. Merrill*, 107 Cal. 446, 48 Am. St. Rep. 145; 1900, *Moxham v. Grant*, 69 L. J. Q. B. 97, 81 L. T. (N. S.) 431, *supra*, p. 1794); the statute of limitations relating to penalties generally, applies (1896, *State Sav. Bank v. Johnson*, 18 Mont. 440, 56 Am. St. Rep. 591).

## ARTICLE II. PARTICULAR KINDS OF CONTRACTUAL LIABILITY.

Sec. 705. 1. As to legal character.

(a) Secondary, limited and joint.

See *Umsted v. Buskirk*, 17 Ohio St. 113, *supra*, p. 1990; *Zang v. Wyant*, 25 Colo. 551, *infra*, p. 2005.

*Note.* See, 1890, *Barrick v. Gifford*, 47 Ohio St. 180, 21 Am. St. Rep. 798; 1895, *National Bank v. Dillingham*, 147 N. Y. 603, 49 Am. St. Rep. 692; 1899, *Gillin v. Sawyer*, 93 Maine 151, 44 Atl. Rep. 677.

Compare, 1894, *Hunting v. Blun*, 143 N. Y. 511.

Sec. 706. Same. (b) Secondary, unlimited, and several.

ANDREW HANSON v. CORNELIUS DONKERSLEY.<sup>1</sup>

1877. IN THE SUPREME COURT OF MICHIGAN. 37 Mich. Rep. 184-195.

*Assumpsit.* The Morgan Iron Company owed Hanson for labor, and he consented to extend the time of payment and accepted their note. He afterwards recovered judgment on the note, but as the execution was returned unsatisfied he sued Donkersley as a stockholder under Corp. L., § 2852, which imposes upon stockholders an individual liability for labor done for the corporation, and allows it to be enforced at any time after the return of an execution unsatisfied, or after the corporation has been declared bankrupt. The court below instructed the jury that in suing the company upon the note instead of the original claim, the plaintiff treated the note as a payment and precluded himself from recovering against the stockholders, and directed a verdict for defendant. Plaintiff brought error.

CAMPBELL, J. This case is certainly not free from difficulty. But it seems to me that the liability of the individual members of corporations for their debts, under the statute upon which this suit was brought, can not in any just sense be called a primary liability. The debts which they are called on to pay are in fact—as they are expressly regarded in the constitution—debts of the corporation. The statute is clear that the private parties shall not be called upon unless the corporation has failed to pay, and legal remedies are exhausted, either by unsatisfied execution or by bankruptcy legally adjudged. The right of recovering contribution by legal action is only given where the payment made by the suing party is compulsory. He has no right to make payment without necessity, and if he does so, he must seek redress in some other way. Corp. L., § 2852.

The corporation is in law a different person from any of its mem-

<sup>1</sup> Only the opinion of Campbell, J., is given. Arguments, concurring opinion of Graves, J., and dissenting opinion of Marsten, J., omitted.

bers. A promise by a stockholder to pay a corporation debt is in every sense a promise to pay the debt of another. The case can not be different merely because the obligation is statutory. It may be that the statute could be so framed as to create a joint, or a joint and several responsibility which could be legislated into a primary obligation. But where the corporation is not put into such relations, and the stockholder can not be called on until the remedy against the corporation has been tried and exhausted, it is entirely plain that they are not both original debtors, and that one is only collaterally liable, and is therefore in law a mere surety. It is still plainer where, as here, he has no right to pay in the first instance.

The constitution by making stockholders "individually liable" for labor debts, does not thereby necessarily make them primarily liable. Bank corporators are made "individually liable" for bank debts contracted during their connection with the banks. Originally this was unlimited. Now it is limited. It would be impossible to regard this limited responsibility as a primary debt of the stockholders. It requires peculiar legislation to reach such cases at law at all. If the constitution could be regarded as making them primary debtors, the remedy could not be enforced except in equity, unless in very peculiar cases, if it could be at all. Here the plaintiff sued expressly under a statute which treats the stockholder in all respects as a several surety, and he must, I think, be so treated in determining his responsibility. It can not be denied that if defendant is a surety, he was discharged from the debt for labor by taking the corporate note and giving time. In my view of the case no other question arises, and the judgment should be affirmed. \* \* \*

Affirmed.

Graves, J., Cooley, C. J., concurring in the conclusion; Marsten, J., dissenting.

*Note.* See preceding case. Compare, 1899, *Foster v. Row*, 120 Mich. 1, 77 Am. St. Rep. 565.

Sec. 707. Same. (c) Primary, unlimited, partnership.

HARGER AND ANOTHER v. McCULLOUGH.<sup>1</sup>

1846. IN THE SUPREME COURT OF NEW YORK. 2 Denio (N. Y.) Rep. 119-125.

[Action against McCullough, as a stockholder in the Rossie Galena Company, to enforce his liability under the New York statute. He moved for a nonsuit upon various grounds, one of which was that his statutory liability was that of a surety only, and that he had been discharged from liability by an extension of the time of payment to the corporation. This was overruled, and exceptions taken.]

BRONSON, C. J. \* \* \* The charter makes the stockholders

<sup>1</sup> Statement abridged; part of opinion omitted.

“jointly and severally personally liable for the payment of all debts or demands contracted by the said corporation.” (Section 9.) But they can not be sued until a judgment has been recovered against the corporation and an execution has been returned unsatisfied. (Section 10.) As between themselves we have regarded the stockholders as standing in the character of partners. (Moss v. Oakley, 2 Hill 265; Bailey v. Bancker, 3 Hill 188.) But in reference to creditors, they have been spoken of as guarantors or sureties of the company. (Moss v. McCullough, 5 Hill 131.) If they are to be regarded in all respects as sureties, then it is quite clear that the defendant has been discharged by the acts of the plaintiffs, who have twice given time to the company without his consent. But I think the stockholders in their individual, as well as their corporate capacity, are principal debtors. Although they have been incorporated with many of the privileges usually granted to men associated in that form, yet the privilege of exemption from personal liability for the debts of the company has been denied to them, and their personal liability has been expressly declared. They are thus placed, in relation to the creditors of the company, upon the same footing as though they were an unincorporated association or partnership.

That is the view which was taken of the question under a charter of the same nature in Allen v. Sewall (2 Wend. 327), and although that judgment was reversed (6 Wend. 335), yet upon this point the members of the court of errors who delivered opinions agreed substantially in the doctrine which had been laid down by this court. And in Moss v. Oakley we considered the stockholders liable in the same manner as though they had gone on with the business as an unincorporated association, which is nothing but a partnership. And this doctrine was practically applied in Bailey v. Bancker, where we held that one member of the association or partnership could not sue another for a debt due from the company. I consider the legislature as saying to those who applied for the charter, “you may have a corporate capacity for the convenience of transacting business, and the facility of transferring your respective interests in the joint concern, but you shall remain liable to the creditors of the association in the same manner, substantially, as though you had not been incorporated.” In one respect the burden was made more onerous than it would have been in going on without a charter, for the copartners are *severally* as well as jointly liable. But that does not affect the principle. Nor is it affected by another provision, which lightens the burden by saving the stockholders from an action until the creditor has attempted to collect the money from the corporation by proceeding to a judgment and execution. The stockholders are debtors from the beginning, although the creditor has no remedy against them until he has first tried to collect from the company. This is no more than applying an equitable principle, which requires that the debts should be paid from the joint funds of the associates, rather than from the separate property of any one of them. I think the defendant was

answerable to the plaintiffs as a principal debtor,<sup>1</sup> and consequently that he was not discharged by giving time to the company. \* \* \*  
New trial denied.

*Note.* See, 1896, McGowan v. McDonald, 111 Cal. 57, 52 Am. St. Rep. 149; 1899, Sacramento Bank v. Pacific Bank, 124 Cal. 147, 71 Am. St. Rep. 38; 1899, Fidelity Ins. T. & S. D. Co. v. Mechanic's Bank, 97 Fed. Rep. 297 (Kan.); 1899, Foster v. Row, 120 Mich. 1, 77 Am. St. Rep. 565.

Sec. 708. Same. (d) Primary, limited, joint, enforceable only in equity.

#### COLEMAN V. WHITE.<sup>1</sup>

1861. IN THE SUPREME COURT OF WISCONSIN. 14 Wis. Rep.  
\*700—\*705.

DIXON, C. J. Section 18 of the general banking law, chapter 71, Revised Statutes, declares: "The stockholders in every corporation or association, organized under the provisions of this chapter, shall be individually responsible, to the amount of their respective share or shares of stock, for all its indebtedness and liabilities of every kind." This is an action at law founded upon this section, instituted by the plaintiff as a creditor of the City Bank of Racine, a corporation organized under the act, against the defendant, an individual stockholder, to recover a debt due from the bank; and the questions presented relate to the nature of the liability imposed and the form of remedy to be pursued. Other questions are presented by the case, but the disposition we make of these renders their consideration unnecessary.

We are of opinion that the liability is primary and absolute, and attaches the moment the debt is contracted by the bank—that it is a liability of all the stockholders to all the creditors, on the principle of copartnership, the stockholders standing on substantially the same footing as though they were partners or an [un]incorporated association, save only that the responsibility of each is limited to a sum equal to his share or shares of stock. Subject to this limitation they are answerable as original and principal debtors, and their liability more nearly resembles that of copartners than any other with which it can be compared. These positions, it is believed, are fully sustained by the following authorities: Marcy v. Clark, 17 Mass. 330; Allen v. Sewall, 2 Wend. 327; Sewall v. Allen, 6 Wend. 335; Moss v. Oakley, 2 Hill 265; Harger v. McCullough, 2 Denio 119; Corning v. McCullough, 1 Coms. 47; Matter of Empire Bank, 18 N. Y. 199; Mokelumne Co. v. Woodbury, 14 Cal. 265; Wright v. Field, 7 Porter's Ind. 376; Planters' Bank v. Bivingsville Man. Co., 10 Rich. Law. 95, and cases hereafter cited.

<sup>1</sup> Argument and part of opinion omitted.

We are persuaded that the remedy should be by suit in equity, in which all the creditors should join, or one or more of them should sue for the benefit of all, and that the action should be against the bank and all the stockholders, unless it be impossible or impracticable to bring them all before the court, or some other sufficient cause for the omission be shown. This conclusion, we think, follows necessarily from the nature of the obligation imposed, it being a liability on the part of all the stockholders, in proportion to the amounts of their respective shares, to all the creditors according to the sums severally due them. It is an indebtedness which a court of law has no power to regulate and adjust, and to which the jurisdiction and powers of equity are peculiarly and exclusively adapted. The creditors should all join, because they have a common interest in the funds to be realized; or, if the action be commenced by one or more of them, the complaint should be so framed that the others may come in and prove their claims before the court or a referee, and share in the distribution of the moneys received. All the stockholders should be made defendants, because they, too, have a common interest, and without their presence it is impossible to adjust their rights and liabilities, and protect them from unequal and oppressive burdens. The same reasons exist for making all the stockholders parties to such actions as in proceedings against delinquent stock subscribers to compel them to contribute toward the payment of the debts of an insolvent or bankrupt corporation. See *Adler v. Milwaukee Pat. Brick Co.*, 13 Wis. \*57. The corporation should be joined, unless it has been dissolved, or its assets wholly exhausted, for the reason that both creditors and stockholders are interested in closing its affairs and in having its available property appropriated to the payment of debts, without which there can be no final settlement and adjudication of the rights and liabilities of the parties. \* \* \*

Reversed.

*Note.* See note preceding case.

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**Sec. 709. Same. (c) Primary, limited, several, enforceable at law.**

**THE BANK OF POUGHKEEPSIE v. IBBOTSON.<sup>1</sup>**

1840. IN THE SUPREME COURT OF NEW YORK. 24 Wend. (N. Y.) Rep. 473-480.

[Action at law against a stockholder to enforce his statutory liability.]

NELSON, C. J. The principal question sought to be presented in this case is whether "an action at law" will lie to charge the stockholder personally under the act.

<sup>1</sup> Statement and argument omitted.



The seventh section provides that for all debts due and owing by the company at the time of its dissolution, the persons then composing it shall be individually responsible to the extent of their respective shares of stock. 3 R. S. 222. It has been repeatedly held that the dissolution here spoken of in order to subject the shareholder may be shown short of judicial proceedings for that purpose. Having ceased to act, and being without funds and indebted, it is to be deemed dissolved so far as to give the remedy to the creditor. 19 Johns. Rep. 456; Hopk. 300; 8 Cowen 387. This dissolution *sub modo* being proved, the liability of the stockholder, as declared by the act, becomes absolute, and I see no valid objection to the enforcement of it in a court of law. There can be no greater difficulty in establishing or resisting the demand there than in a court of equity, as the ground and extent of the liability are distinctly given. It is true the stockholder may be subjected to several suits, but he can be charged only to the extent of his stock. Beyond this his defense is as perfect at law as in equity. On payment of debts, or a personal charge in respect to them to this amount, there is an end to further liability. It was made a question in the several cases above referred to whether the suit in equity could be maintained on the ground of a remedy at law; the answer given confirms the view we have taken—it is that the creditor is entitled to contribution from all the stockholders, if requisite to the satisfaction of his debt, and that numerous suits might become necessary. To avoid this, he may resort to that court. The creditors, if more than one, may also, it seems, if they apprehend a deficiency in the fund, enforce in equity a *pro rata* distribution. 8 Cowen 392. But this must be at their election. Any difficulty that may exist on the part of the stockholder, in protecting himself beyond the statute liability, has never been suggested as a ground for proceedings in equity. Indeed, it is clear that as to him the defense is as perfect, if not as simple, in the one court as in the other. This question has been before the chancellor in an analogous case, in which he held, inasmuch as the creditors had a concurrent remedy at law, the statute of limitations applicable to the proceedings there equally governed in equity. 3 Paige 409. See, also, Angel & Ames on Corp. 369.

It is supposed the pleader should have set out in the declaration the grounds upon which a dissolution is predicated. We think not. The fact upon which the statute liability depends in this respect, to wit, the dissolution, is averred, and the decisions point out the nature of proof required to establish it.

There can be no doubt that the liability of the stockholders is *several* and not *joint*. The measure of it may be wholly different in each case, depending upon the shares held. A joint suit would be impracticable, as there could be no joint judgment. Besides, the act did not intend they should be sureties for each other. Each is severally responsible to the amount of his own stock.

The plaintiffs, I think, are entitled to judgment on the demurrer.

*Note.* 1. *Several*: See, 1866, Umsted v. Buskirk, 17 Ohio St. 114, *supra*, p. 1990; 1890, Barrick v. Gifford, 47 Ohio St. 180, 21 Am. St. Rep. 798; 1892, Willis

v. Mabon, 48 Minn. 140, 31 Am. St. Rep. 626; 1898, Hanson v. Davison, 73 Minn. 454, 76 N. W. Rep. 254; 1898, Sedgwick City Bank v. Sedgwick M. Co., 59 Kan. 654, 54 Pac. Rep. 681; 1898, Hancock Nat'l Bank v. Ellis, 172 Mass. 39, 70 Am. St. Rep. 232, 42 L. R. A. 396.

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Sec. 710. Same. 2. As to amount.  
(a) Unlimited.

See §§ 666, 707, *supra*.

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Sec. 711. Same. (b) Double. Who liable.

HENRY ROOT v. THOMAS SINNOCK.<sup>1</sup>

1887. IN THE SUPREME COURT OF ILLINOIS. 120 Ill. Rep. 350-361, 60 Am. Rep. 558.

[Appeal from lower court overruling a demurrer to the plaintiff's petition to charge defendant upon his statutory liability as a shareholder in the Union Bank of Quincy.]

MR. JUSTICE SCHOFIELD. \* \* \* *First*. The contention of appellant is that the liability imposed by the seventh section of the charter of the Union Bank of Quincy upon the stockholders is simply to pay the creditors of the bank the balance unpaid upon subscriptions for stock. The language of the seventh section, affecting this question, is: "*Provided, also*, That the stockholders in this corporation shall be individually liable, to the amount of their stock, for all debts of the corporation, and such liability shall continue for three months after the transfer of any stock on the books of the corporation." The plain and obvious meaning of this language is, to our minds, the stockholders are liable to creditors for their debts to an extent measured by the amount of their stock. Omitting the clause expressing the extent of liability, and we have this: "The stockholders in this corporation shall be individually liable for all debts of the corporation." If this were all, their liability would be unlimited—they would be absolutely liable for all debts of the corporation. The intention, however, is to limit that liability; but to what extent? The answer is: "To the amount of their stock"—not to the amount unpaid upon their stock. The language makes the liability because of the fact of being stockholders, and not because of the fact of being debtors of the corporation. If the liability intended was simply to pay the creditors the amount due the corporation, what would have been more natural and easy than to have used just that language? The difference between a stockholder and a debtor for unpaid stock is

<sup>1</sup> Statement, arguments, and part of opinion omitted.

recognized in several of the sections, and so was, at the time, in the legislative mind, and it must therefore be presumed that words expressing the one would not have been used to express the other in this instance. \* \* \*

But this ought not now to be regarded an open question in this court. We have in numerous cases, without much discussion, it is true, held or assumed that language of the same, or substantially the same, import, meant what we have indicated in our opinion this means. *Culver v. Third Nat'l Bank of Chicago*, 64 Ill. 528; *Tibballs et al. v. Libby*, 87 Ill. 142; *Bromley v. Goodwin*, 95 Ill. 118; *Wincock v. Turbin*, 96 Ill. 141; *Harper v. Union Manf. Co.*, 100 Ill. 225; *Eames et al. v. Doris*, 102 Ill. 350; *Thompson v. Meisser*, 108 Ill. 362; *Queenan et al. v. Palmer et al.*, 117 Ill. 619. And the same construction has been placed upon like language in New York and Pennsylvania. *Slee v. Bloom*, 20 Johns. 683; *Briggs v. Penniman*, 8 Cow. 395; *Bank of Poughkeepsie v. Ibbotson*, 24 Wend. 473; *Matter of Empire City Bank*, 18 N. Y. 218; *Lane's Appeal*, 105 Pa. St. 49, 57.

*Second.* The next question is, should it affirmatively appear that appellant was a stockholder when the cause of action accrued, or is it sufficient that he was a stockholder when suit was brought? In our opinion, it is sufficient that appellant was a stockholder when suit was brought. The liability is because of being a stockholder—that is, because of the ownership of stock. (*Wheelock v. Kost*, 77 Ill. 296.) As was said in *Brown v. Hitchcock*, 36 Ohio St. 681, “the expression, ‘all stockholders,’ must be regarded, in the absence of any legislative indication to the contrary, as including not only those who were such at the time the indebtedness was incurred, but all those who successively stand in their shoes in respect to the same stock.” The liability being because of the ownership of stock, it follows the stock into whosoever hands it may go, and whoever purchases it does so at the risk of this liability, and in consonance with this view, we have held that the liability once discharged, the stock is thereafter free of any further liability on account of ownership. *Thebus v. Smiley*, 110 Ill. 316.

The rule is thus stated in *Thompson on Liability of Stockholders*, section 90: “But in the absence of special statutory provisions, the general rule, applicable alike to the English joint stock company and the American corporation, is, that liability as contributors, or to creditors, attaches not merely to those who are members at the time or before the debt was contracted, but to those who were such, either, first, when by reason of the stoppage, dissolution or winding up of the company, the right to transfer shares ceased; or, second, in the case of direct proceedings by creditors against shareholders, when the right of the creditors against the shareholder became fixed in an appropriate proceeding.” See, also, to like effect, *Middleton Bank v. Magill*, 5 Conn. 28; *Curtis v. Harlow* 12 Metc. 3; *Holyoke Bank v. Burnham*, 11 Cush. 183; *Johnson v. Summerville Dr. Bl. Co.*, 15 Gray 216; *McCulloch v. Moss*, 5 Denio 567; *Matter of Empire Bank*,

18 N. Y. 199; Johnson v. Underhill, 52 N. Y. 203; McClaren v. Franciscus, 43 Mo. 464. \* \* \*

*Affirmed.*

*Note.* See, 1889, Harpold v. Stobart, 46 Ohio St. 397, 15 Am. St. Rep. 619; 1896, Harper v. Carroll, 66 Minn. 487; 1899, Foster v. Row, 120 Mich. 1, 77 Am. St. Rep. 565; 1900, Wick Nat'l Bank v. Union Nat'l Bk., 62 Ohio St. 446, 78 Am. St. Rep. 734.

See, also, *supra*, §§ 566, 567, as to effect of transfer.

**Sec. 712. Same.** Double liability; assignee can not enforce; suit only after corporation can not pay.

**ZANG v. WYANT.<sup>1</sup>**

1898. IN THE SUPREME COURT OF COLORADO. 25 Colo. Rep. 551, 71 Am. St. Rep. 145.

[Equitable action by creditors on behalf of themselves and such other creditors as might join them to enforce the statutory liability of shareholders in an insolvent bank. Judgment below was for plaintiffs, and defendants appealed.]

GODDARD, J. \* \* \* Counsel for appellants insist that the assignee was alone entitled to maintain the action, and that the creditors themselves can not invoke the interposition of a court of equity to enforce the liability of stockholders under this statute. Upon whom the right to enforce the remedy devolves, and the mode of procedure that should be adopted, have been in controversy in many of the courts of last resort, and have been variously decided, some holding that the liability is primary, and enforceable in an action at law by an individual creditor against one or more of the stockholders, while in others, and by far the greater number, it is held that the fund created by the statute is in the nature of a security for the common benefit of all the creditors, and that a suit in equity affords the most effectual and convenient remedy for its enforcement; that since the fund is exclusively for the benefit of the creditors, and forms no part of the assets of the corporation, the right of action accrues to the creditors themselves, and, in the absence of a statute conferring the right, neither the assignee nor receiver of an insolvent corporation can maintain the action. Terry v. Little, 101 U. S. 216; Pollard v. Bailey, 20 Wall. 520; Horner v. Henning, 93 U. S. 228; Farnsworth v. Wood, 91 N. Y. 308; Pfohl v. Simpson, 74 N. Y. 137; Mathez v. Neidig, 72 N. Y. 100; Griffith v. Mangan, 73 N. Y. 611; Wincock v. Turpin, 96 Ill. 135; Dutcher v. Marine Nat. Bank, 12 Blatchf. 435; Jacobson v. Allen, 20 Blatchf. 525; Minneapolis Paper Co. v. Swinburne, etc., Co., 66 Minn. 378; Umsted v. Buskirk, 17 Ohio St. 113; Wright v. McCormack, 17 Ohio St. 86; Crease v. Babcock, 10 Met. 525; Lib-

<sup>1</sup> Statement abridged, arguments and part of opinion omitted.

erty Female, etc., Association v. Watkins, 70 Mo. 13; Runner v. Dwiggins, 147 Ind. 238; Cook on Stock and Stockholders, § 280; Thompson on Corporations, § 3560; Morawetz on Private Corporations, § 869.

In Terry v. Little, 101 U. S. 216, Chief Justice Waite, in discussing the procedure that should be adopted for the enforcement of a liability provided in the charter of the Merchants' Bank of South Carolina, in language substantially the same as that used in our statute, said: "Undoubtedly the object was to furnish additional security to creditors, and to have the payments when made apply to the liquidation of debts. So, too, it is clear that the obligation is one that may be enforced by the creditors; but as it is to or for all creditors it must be enforced by or for all. The form of the action, therefore, should be one adapted to the protection of all." \* \* \*

(Citing and quoting from, to the same effect, Pfohl v. Simpson, 74 N. Y. 137; Runner v. Dwiggins, 147 Ind. 238.)

We have carefully examined the cases cited and relied upon by counsel for appellants as sustaining their contention. It is true that these cases, while holding that the fund can be reached only by a proceeding in equity, sustain the right of the receiver to enforce the remedy. We are, however, satisfied that the foregoing cases announce the generally accepted rule, and that, both upon reason and authority, the additional liability of stockholders imposed by our statute constitutes a fund for the benefit of all the creditors, which may be pursued in equity for their common benefit by or for all; and an assignee whose trust relates only to the corporate assets acquires no right to enforce this statutory obligation.

The right to maintain the present action is also challenged because it is prematurely brought. It is argued that if, as we have seen, the fund provided by the statute is in the nature of an additional security for the creditors, the liability of the stockholders is secondary and not enforceable until the assets of the corporation have been exhausted. It is undoubtedly true that this fund does not constitute the primary or regular fund for the payment of the corporate liabilities, and that the corporate funds are the primary resource to which creditors must look for the payment of their debts and the discharge of the corporate obligations; but a well recognized exception to this rule exists when, by reason of dissolution or insolvency, an action against the corporation would be unavailing. Cook on Stock and Stockholders, § 200; Terry v. Tubman, 92 U. S. 156; Hodges v. Silver Hill Min. Co., 9 Ore. 200.

We think the facts averred in the complaint and disclosed by the evidence bring this case within this exception. It appears that the North Denver Bank, on July 18, 1893, was insolvent, and made an assignment of all its assets, that the appellees filed their claim with the assignee, and the same were allowed, and there has been paid only twenty per cent. of the original amounts. No further sum having been realized during the length of time that has elapsed, it is evident that the remaining assets, if any, consist of worthless or doubtful

claims. Under these circumstances, the creditors ought not to be compelled to await their collection, or delay the enforcement of the statutory liability against the stockholders; but justice requires that the stockholders themselves should be compelled to pay their claims, and look to the assignee for whatever may be realized from the remaining assets: *Moses v. Ocoee Bank*, 1 Lea 398; *Stark v. Burke*, 9 La. Ann. 341. As was said in the former case: "They (creditors) will not be required to wait the collection of doubtful claims, or claims in litigation. The stockholders must pay promptly and take upon themselves the onus of delay and risk as to all such claims." For these reasons we think the foregoing objections to the maintenance of this action by appellees were properly overruled.

It is further contended that the court below erred in its conclusion as to the extent of the liability imposed by the statute, and in rendering judgment against each of the stockholders in double the amount of the par value of the stock owned by them respectively.

The language of the statute is: "Shareholders in banks \* \* \* shall be held individually responsible for debts \* \* \* of said associations, in double the amount of the par value of the stock owned by them respectively."

It is said that the true intent and meaning of this language is to make the stockholders responsible to the amount of stock subscribed, and in addition thereto a sum equal to its par value, or, as expressed by counsel: "He is first liable to the corporation to the full par value of his stock, and next liable to the creditors in an equal amount"; and that this constitutes the double liability contemplated by the statute; that the judgment of the court below in effect imposed upon them a triple liability. As supporting this view, counsel cite *Beach on Private Corporations*, § 152; *Thompson's Liability of Stockholders*, § 37; 1 *Cook on Stock and Stockholders*, § 215; 2 *Morawetz on Private Corporations*, § 881.

For instance, as said by Mr. Beach: "Statutes imposing a liability 'to double the amount of stock held by them' receive the same construction as those making shareholders liable 'to the amount of their stock.'" And like expressions are found in the other works referred to. As supporting this conclusion they cite *Perry v. Turner*, 55 Mo. 418; *Matthews v. Albert*, 24 Md. 527; *Norris v. Johnson*, 34 Md. 485; *Booth v. Campbell*, 37 Md. 522; *Schricker v. Ridings*, 65 Mo. 208; *Gay v. Keys*, 30 Ill. 413.

In addition to these, Mr. Beach also cited *Appeal of Parish* (Pa., March 24, 1890), 19 Atl. Rep. 569.

Upon a careful examination of these cases we are unable to find any warrant for the rule as announced. \* \* \*

We find no expression in any of these decisions that intimates that statutes imposing a liability "to double the amount of stock held" should be given the same signification and receive the same construction as those making shareholders liable "to the amount of their stock," except in *Perry v. Turner*, 55 Mo. 418, where the court refers to section 6, article 8, of the constitution of Missouri of 1865, which



provides that stockholders should be individually liable, over and above the stock owned by them, in a further sum at least equal in amount to such stock, as creating a double liability. While in Appeal of Parish (Pa., March 24, 1890), 19 Atl. Rep. 569, a case that involved the construction of a statute which, like ours, imposed a liability upon stockholders "to the extent of double the amount of their stock," the court clearly shows that this language is not to be construed to mean the same as that which limits the liability of stockholders "to an amount equal to the stock held," but that the latter phrase imposes a single, while the former imposes a double, liability.

It has been almost uniformly held that when a statute fixes the liability of stockholders "in an amount equal to the stock held by them," or "to the amount of their stock," it imposes a liability to the amount of the par value of their shares, in addition to their subscription to the stock: *McDonnell v. Alabama Gold Life Ins. Co.*, 85 Ala. 401; *Briggs v. Penniman*, 8 Cow. 387, 18 Am. Dec. 454; *Pettibone v. McGraw*, 6 Mich. 441; *Root v. Sinnock*, 120 Ill. 350, 60 Am. Rep. 558; *Lane's Appeal*, 105 Pa. St. 49, 51 Am. Rep. 166; *Buenz v. Cook*, 15 Colo. 38.

It therefore logically follows that where the language is "in double the amount of stock held," an obligation in double the amount of such par value is imposed: *Appeal of Parish* (Pa., March 24, 1890), 19 Atl. Rep. 569; *Terry v. Little*, 101 U. S. 216.

In the latter case, the charter under consideration provided that stockholders should "be liable and held bound \* \* \* for any sum not exceeding twice the amount of \* \* \* their \* \* \* shares." After quoting this language, Chief Justice Waite said: "This, as we think, means that on the failure of the bank each stockholder shall pay such sum, not exceeding twice the amount of his shares, as shall be his just proportion of any fund that may be required to discharge the outstanding obligations."

Although the double liability clause, as found in our statute, is, and for several years has been, in force, either by virtue of constitutional, statutory or charter provisions, in the states of Illinois, Minnesota and Pennsylvania, we are aware of no case wherein it has been expressly passed on and construed except in the *Appeal of Parish* (Pa., March 24, 1890), 19 Atl. Rep. 569. There are, however, cases which reached the courts of final resort in these jurisdictions where the amount recoverable thereunder was necessarily involved, and while the meaning of this clause was in no way raised or discussed, from an examination of the cases it will be seen that a liability in double the amount of the stock in addition to the subscription was enforced: *McCarthy v. Lavasche*, 89 Ill. 270, 31 Am. Rep. 83; *Munger v. Jacobson*, 99 Ill. 349; *Harper v. Carroll*, 66 Minn. 487; *Allen v. Walsh*, 25 Minn. 543.

As we have seen, statutes of this character are intended to furnish a fund exclusively for the benefit of creditors, and under the rule laid down in all cases, they are to be construed as imposing an individual liability upon stockholders, in addition to their liability to the cor-

poration for the amount of their subscription to the stock. Accepting this as the correct rule of construction, the plain and obvious import of the language of our act is to make stockholders in banking associations individually liable for the debts of the association in double the amount of the par value of the stock owned by them, notwithstanding they may have paid, or are still liable to the corporation, for their original subscription. \* \* \*

(Affirmed, except as to certain items of debt, and rehearing denied.)

*Note.* See *infra*, §§ 715-721.

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**Sec. 713. Same. (c) Proportional.**

RHODES, J., IN LARRABEE v. BALDWIN ET AL.<sup>1</sup>

1868. IN THE SUPREME COURT OF CALIFORNIA. 35 Cal. Rep. 155, on 177, 178.

The question involved was as to whether a creditor, in his recovery against an individual stockholder on his personal liability, is limited to the stockholder's share of that particular debt, or whether he can recover the whole amount of his debt (if not exceeding the whole amount for which the shareholder is liable).

The solution of the questions upon which the rehearing was granted depends, in my judgment, upon the construction of section 16 [act of 1853], and not of section 32 [act of 1850].

The first clause of section 16 declares the liability of stockholders. "Each stockholder shall be individually and personally liable for his proportion of all the debts and liabilities of the company contracted or incurred during the time that he was a stockholder." The remainder of the section relates to the mode of procedure in ascertaining and determining the amount of the debts for which each stockholder is liable. Joint and several actions may be instituted. The stockholder may prove, and there shall be allowed to him, in reduction of the amount for which he would otherwise be liable, in a suit brought by a creditor, the amount which he may have paid upon "any debt or liability of such corporation," and, thereupon, judgment shall be given for a sum not exceeding his "proportion of the debts and liabilities of such corporation," less the amount previously paid by him.

That is to say, each stockholder is liable for his proportion of all the debts and liabilities of the corporation, and for nothing beyond; and upon his payment of such proportion his liability ceases. Suppose the debts of the corporation amount to one hundred thousand dollars, and that there are one hundred stockholders, each holding the same amount of stock. When one stockholder has paid a creditor

<sup>1</sup> This case discusses the nature of proportional liability pretty fully, in the opinion of Sawyer, C. J., and the dissenting opinion of Crockett, J.

one thousand dollars he is no longer liable to the other creditors. Under that section he is clearly authorized to exhaust his whole liability in the satisfaction of the debt of one creditor, and the other creditors must look to the corporation and the other stockholders for the payment of their demands. This construction, it is true, may enable the diligent creditor to secure the payment of his demand from the only solvent stockholder in the company and leave the other creditors without remedy except against the corporation, which may, perhaps, be insolvent. This result certainly would ensue should the only solvent stockholder exhaust his liability for his proportion of all the debts of the corporation in the payment without suit of the claims of one or more of the creditors. This results not from construction, but from the positive terms of the act.

Should the opposite construction be given, consequences more injurious to the creditors and more absurd in their results would ensue. The solvent stockholder in the supposed corporation pays ten dollars on any debt or liability of the corporation; and in each of the suits brought by creditors whose claims do not severally exceed one thousand dollars, he relieves himself from responsibility by proving his one payment of ten dollars. Had the stockholder paid one hundred dollars he would not be liable to any creditor whose claim did not exceed ten thousand dollars. \* \* \*

Crockett, J., dissents. \*

Sec. 714. Same. (d) For labor and services.

IN THE MATTER OF STRYKER.<sup>1</sup>

1899. IN THE COURT OF APPEALS OF NEW YORK. 158 N. Y. Rep. 526-532.

O'BRIEN, J. The courts below have determined, by the order appealed from, that four different and distinct claims presented to the receivers were not entitled to the preference provided by chapter 376 of the laws of 1885. One of the claims was presented by a clerk and bookkeeper, who had been employed in the office of the corporation at a salary of \$100 a month, payable at the end of each month. Another by the superintendent of the corporation, who had been employed at a salary of \$125 a month. Another by a draughtsman, employed in the office of the corporation at a salary of \$125 a month, and the other claim was made by two foremen employed by the corporation, one in the boiler shop, at a salary of \$225 a month, and the other in some other department at a salary of \$125 a month.

The question is whether these claims were entitled to a preference under the provisions of the statute, which reads as follows: "Where a receiver of a corporation created or organized under the laws of this state, and doing business therein, \* \* \* shall be appointed, the wages of the employes, operatives and laborers thereof shall be pre-

<sup>1</sup> Arguments, part of opinion of O'Brien, J., and all of concurring opinion of Gray, J., omitted.

ferred to every other debt or claim against such corporation, and shall be paid by the receiver from the moneys of such corporation which shall first come to his hands."

It is said that the applicants were employes of the corporation, and doubtless that assertion is correct. But the word employe would include every person in the service of the corporation, without regard to his grade or rank, or the nature of his duties. If preference should be given to the claims of these parties on the ground that they were employes of the corporation, we would necessarily have to exclude the other words, "operatives and laborers." When two or more words of analogous meaning are employed together they are understood to be used in their cognate sense, to express the same relations and give color and expression to each other. Hence, although the word employe is general and comprehensive, it must be limited by the more specific words, operatives and laborers, which are found in the statute. (*Wakefield v. Fargo*, 90 N. Y. 218; *People, ex rel. Satterlee, v. Board of Police*, 75 N. Y. 44.)

The most important word in the statute is the word "*wages*." It was wages that the legislature intended to prefer, in the distribution of the assets of the insolvent corporation, not salaries, nor earnings, nor compensation. It was not intended to prefer the claims of all the employes, but it was manifestly intended to limit the preference to the particular class whose claims would be properly expressed by the use of the word wages. This word is applied, in common parlance, specifically to the payment made for manual labor, or other labor of menial or mechanical kind, as distinguished from salary and from fee, which denotes compensation paid to professional men. (*Century Dictionary*.) In its application to laborers and employes it conveys the idea of subordinate occupation which is not very remunerative, of not much independent responsibility, but rather subject to immediate supervision. This was the construction which this court placed upon the statute in the case of *People v. Remington* (45 Hun 338, affirmed here on the opinion below, 109 N. Y. 631). It was said in that case that the statute was designed to secure the prompt payment of the wages of persons who, as a class, are dependent upon their earnings for the support of themselves and their families, and it was not designed to give a preference to the salaries and compensation due to officers and employes of a corporation occupying superior positions of trust or profit.

\* \* \*

It is in derogation of the common law, and should not be extended to cases not within the reason as well as within the words of the statute. In the distribution of the assets of an insolvent corporation by courts of equity the maxim that equality is equity is a fundamental rule, and it is only by force of legislation that this principle can be departed from, and then only in favor of the class of creditors that come within the scope of the statute when fairly and reasonably interpreted. In a very recent case we were required to pass upon the claim of an attorney at law which it was contended was entitled to preference under the terms of the statute. In a general sense it might well be said that he was an employe since he was retained or em-

ployed in the business of the corporation, but it was held that he was not a laborer or servant within the scope or policy of the statute. (*Bristor v. Smith*, 158 N. Y. 157.) While the claim in that case was not based upon the statute in question, but upon another of a kindred nature, the reasoning applies to the claims in question. We adhere to the doctrine there announced in the opinion of Judge Gray as a correct interpretation of the statute.

These views are not in conflict with the case of *Palmer v. Van Santvoord* (153 N. Y. 612). The claimant in that case was not a superintendent, or foreman, or bookkeeper, or clerk. The courts below had held that he was a laborer or operative within the meaning of the statute, and this court affirmed the decision. \* \* \*

*Affirmed.*

*Note.* See, 1872, *Moyer v. Penn. Slate Co.*, 71 Pa. St. 293; 1899, *Foster v. Posson*, 105 Wis. 99, 81 N. W. Rep. 123.

#### ARTICLE III. ENFORCEMENT OF THE STATUTORY LIABILITY.

##### Sec. 715. 1. In general.

See *Umsted v. Buskirk*, 17 Ohio St. 113, *supra*, p. 1990; *Zang v. Wyant*, 25 Colo. 551, *supra*, p. 2005; *Coleman v. White*, 14 Wis. 700, *supra*, p. 2000; *Bank v. Ibbotson*, 24 Wend. 473, *supra*, p. 2001; *Huntington v. Attrill*, 146 U. S. 657, *supra*, p. 1892.

*Note.* 1. While special remedies are provided in some cases, as in the case of the Kansas liability (see *Marshall v. Sherman*, 148 N. Y. 9, *infra*, p. 2021), and in some states an action at law by the creditor directly against the shareholder may be maintained (1900, *Woodworth v. Bowles*, 61 Kan. 569, 60 Pac. Rep. 331), the most usual method, if no other is prescribed, is by a creditor's bill in equity or a similar statutory proceeding: See, 1879, *Terry v. Little*, 101 U. S. 216; 1895, *National Bank v. Dillingham*, 147 N. Y. 603, 49 Am. St. Rep. 692; 1897, *Wallace v. Carpenter Elec., etc., Co.*, 70 Minn. 321, 68 Am. St. Rep. 530; 1898, *Parker v. Carolina Bank*, 53 S. C. 583, 69 Am. St. Rep. 888; 1899, *Foster v. Posson*, 105 Wis. 99, 81 N. W. Rep. 123; 1899, *Maine T. & B. Co. v. Southern L. & T. Co.*, 92 Maine 444; 1900, *Stiles v. Laurel Fork Oil Co.*, 47 W. Va. 835, 35 S. E. Rep. 986.

2. While it has been held that a receiver of the corporate assets can enforce such liability (1896, *Cushing v. Perot*, 175 Pa. St. 66, 52 Am. St. Rep. 835), the better rule certainly is that the receiver or assignee of the corporate assets has nothing to do with such liability, for it is not a corporate asset, but only a security for the creditor: See, 1891, *Bank of N. Am. v. Rindge*, 154 Mass. 203, 26 Am. St. Rep. 240; 1898, *Zang v. Wyant*, 25 Colo. 551, 71 Am. St. Rep. 145, *supra*, p. 2005; 1898, *Brown v. Trail*, 89 Fed. Rep. 641; 1899, *Fidelity Ins. T. & S. D. Co. v. Mechanics' Bank*, 97 Fed. Rep. 297; 1900, *Wigton v. Bosler*, 102 Fed. Rep. (C. C. Pa.) 70; 1900, *Colton v. Mayer*, 90 Md. 711, 78 Am. St. Rep. 456; 1902, *Evans v. Nellis*, 187 U. S. 271; 1903, *Hale v. Allinson*, 188 U. S. 56; 1903, *Finney v. Grey*, 189 U. S. 335.

3. In the case of secondary liability, the creditor must first exhaust his remedy against the corporation, unless it is insolvent and has ceased to do business. See note, *supra*, p. 1997; and, 1873, *Shellington v. Howland*, 53 N. Y. 371; 1890, *Barrick v. Gifford*, 47 Ohio St. 180, 21 Am. St. Rep. 798; 1895, *National Bank v. Dillingham*, 147 N. Y. 603, 49 Am. St. Rep. 692; 1895, *Trades-*

man Pub. Co. v. Car Wheel Co., 95 Tenn. 634, 49 Am. St. Rep. 943; 1898, Wehn v. Fall, 55 Neb. 547, 70 Am. St. Rep. 397; 1898, Sleeper v. Norris, 59 Kan. 555; 1900, Seattle National Bank v. Pratt, 103 Fed. Rep. 62. Compare, 1899, Foster v. Row, 120 Mich. 1, 77 Am. St. Rep. 565.

4. As to parties, see note, *supra*, p. 2005.

5. *Statute of limitations*: As a general rule the statute begins to run only after judgment and unsatisfied execution against the corporation, or insolvency and ceasing to do business. See, 1875, Kincaid v. Dwinelle, 59 N. Y. 548; 1887, Hollingshead v. Woodward, 107 N. Y. 96 (only after actual dissolution); 1890, Barrick v. Gifford, 47 Ohio St. 180; 1892, Younglove v. Lime Co., 49 Ohio St. 663; 1892, Bronson v. Schneider, 49 Ohio St. 438; 1896, State Sav. Bank v. Johnson, 18 Mont. 440, 56 Am. St. Rep. 591; 1898, Kelly v. Clark, 21 Mont. 291; 1898, Van Pelt v. Gardner, 54 Neb. 701; 1899, Crofoot v. Thatcher, 19 Utah 212, 75 Am. St. Rep. 725; 1900, Steffins v. Gurney, 61 Kan. 292, 59 Pac. Rep. 725; 1900, Ryland v. Com. & Sav. Bank, 127 Cal. 525, 59 Pac. Rep. 989; 1900, Seattle Nat'l Bank v. Pratt, 103 Fed. Rep. 62. See note, 96 Am. St. R. 972.

6. Suit by one creditor in time saves the rights of all: 1890, Barrick v. Gifford, 47 Ohio St. 180; 1898, Hirshfield v. Fitzgerald, 157 N. Y. 166. But one creditor that sues for himself and others can settle for himself, and dismiss the suit before others actually join: 1898, Hirshfield v. Fitzgerald, 157 N. Y. 166.

7. Enforcement in other states. See Whitman v. Oxford Nat'l Bank, 176 U. S. 559, *infra*, p. 2018; Marshall v. Sherman, 148 N. Y. 9, *infra*, p. 2021; Howarth v. Angle, 162 N. Y. 179, *infra*, p. 2028, with notes.

8. When the constitutional liability is self-executing, see next case and note; 1901, Kulp v. Fleming, 65 O. S. 321, 87 Am. St. R. 611, note 617; 1902, Winchester v. Howard, 136 Cal. 432, 89 Am. St. R. 153.

## Sec. 716. Same. 2. Constitutional provisions, when self-executing.

MITCHELL, J., IN WILLIS v. MABON.

1892. IN THE SUPREME COURT OF MINNESOTA. 48 Minn. Rep. 140, on 149, 150, 31 Am. St. Rep. 626, on 628, 629.

[The constitution provided "each stockholder in any corporation (except manufacturing, etc.) shall be liable to the amount of stock held or owned by him."]

This brings us to the main question, viz., whether this provision of the constitution is self-executing. That such has been the general understanding of the bench, bar, and business men in this state is conceded. This court has, in a long line of cases, assumed that such was the fact. Dodge v. Minnesota Plastic Slate Roofing Co., 16 Minn. 368 (Gil. 327); Allen v. Walsh, 25 Minn. 543; State v. Minnesota Thresher Mfg. Co., 40 Minn. 213 (41 N. W. Rep. 1020); Mohr v. Minnesota Elevator Co., 40 Minn. 343 (41 N. W. Rep. 1074); Arthur v. Willius, 44 Minn. 409 (46 N. W. Rep. 851); Densmore v. Shepard, 46 Minn. 54 (48 N. W. Rep. 528, 681). \* \* \*

The question in every case is whether the language of a constitutional provision is addressed to the courts or the legislature,—does it indicate that it was intended as a present enactment, complete in itself as definitive legislation, or does it contemplate subsequent legislation to carry it into effect? This is to be determined from a con-



sideration both of the language used and of the intrinsic nature of the provision itself. If the nature and extent of the right conferred and of the liability imposed is fixed by the provision itself, so that they can be determined by the examination and construction of its own terms, and there is no language used indicating that the subject is referred to the legislature for action, then the provision should be construed as self-executing, and its language as addressed to the court. In almost every case cited by appellants in which a constitutional provision has been held not self-executing, it will be found either that its language indicated an intention that legislation should be had to carry it into effect, or that the nature of the provision itself was such as to render such legislation necessary. \* \* \*

*Note. Accord:* 1893, *Fowler v. Lamson*, 146 Ill. 472, 37 Am. St. Rep. 163, note 168 (Kans. liability is self-executing); 1898, *Bell v. Farwell*, 176 Ill. 489, 68 Am. St. Rep. 194, 42 L. R. A. 804 (same); 1900, *Whitman v. Nat'l Bank*, 176 U. S. 559, *infra*, p. 2018 (same); 1900, *Hancock Nat'l Bk. v. Farnum*, 176 U. S. 640 (same); 1902, *Rice v. Howard*, — Cal. —, 69 Pac. 77. See § 715, note 8.

*Contra:* 1900, *Woodworth v. Bowles*, 61 Kan. 569, 60 Pac. Rep. 331, *infra*.

**Sec. 717. Same. 3. Self-executing provisions; special remedy; remedy in equity or at law; repeal.**

#### WOODWORTH ET AL. V. BOWLES ET AL.<sup>1</sup>

1900. IN THE SUPREME COURT OF KANSAS. 61 Kan. Rep. 569, 60 Pac. Rep. 331.

DOSTER, C. J. This was a proceeding in equity begun by Thomas Bowles in behalf of himself and others, as creditors of an insolvent banking institution, against R. J. Woodworth and others, as stockholders in the bank, to compel the payment by them of the amounts due on their statutory liability as stockholders, and for a distribution of such amounts among the several creditors of the bank, and to restrain certain of its creditors from the prosecution of actions begun by them against the stockholders to enforce for themselves, and in their several interests, the statutory liability of the latter. Judgment in accordance with the prayer of the petition was rendered in the court below. From that judgment proceedings in error have been prosecuted to this court, and the principal question is, Can an equitable action be maintained for the purpose stated in the plaintiff's petition?

In 1895 the bank of Garnett became insolvent. It was taken in charge by the bank commissioner under the authority of the statute then in force. As required by that statute, a receiver was appointed, who entered upon the labor of converting the assets of the bank into money and distributing it among the creditors. In 1897 the legislature revised the act for the regulation and supervision of banks in their insolvent as well as in their active and solvent condition. Laws

<sup>1</sup> Statement abridged; much of the opinion omitted.

1897, ch. 47. By section 55 of that act it was made the duty of receivers of insolvent banks to prosecute actions for the recovery of the statutory liability of stockholders. That duty had not been theretofore imposed upon the receivers of such banks, but before the taking effect of the statute mentioned the liability of stockholders of banks, as well as of other incorporated institutions, was enforceable only by individual creditors against individual stockholders, unless, as the defendants in error claim, it was enforceable in equity by the creditors collectively. In June, 1897, the action stated was commenced. This was after the taking effect of the law of 1897, which made it the duty of the receiver to institute the proceedings. \* \* \*

After the occurrence of the bank's insolvency, but before the institution of the proceeding in equity, and also before the taking effect of the act of 1897, a large number of the bank's creditors instituted actions under the statute against certain of its stockholders to enforce their individual liability for the payment of its debts. These creditors were made parties defendant to the action in equity before mentioned, and are the plaintiffs in error in this court.

The provisions of law respecting the liability of stockholders of a corporation to pay its debts are both constitutional and statutory. The constitution declares: "Dues from corporations shall be secured by individual liability of the stockholders to an additional amount equal to the stock owned by each stockholder, and such other means as shall be provided by law." Article 12, § 2. Prior to the act of 1897, before referred to, the statutory remedies for the enforcement of the liability ordained by this constitutional provision were those provided by sections 49, 50, chapter 66, General Statutes 1897. By section 49, an action in the form of a petition and summons by the creditor against the stockholder was authorized in the event of a dissolution of the corporation, and by section 50, a proceeding in the form of a motion by the creditor for leave to issue execution against the stockholder was authorized in the event of a previous judgment and unsatisfied execution against the corporation. *Cottrell v. Manlove*, 58 Kan. 405, 49 Pac. Rep. 519. These sections did not provide a remedy by the creditors collectively against the stockholders collectively, but in each of them provision was made for a single proceeding by a single creditor against a single stockholder. This was expressly so declared in *Abbey v. Dry-Goods Co.*, 44 Kan. 415, 24 Pac. Rep. 426, as to the liability of the stockholders to the creditors. In that case it was ruled "the liability of stockholders to the creditors of a corporation is several, not joint, and each must be sued separately." By much the stronger reason should it be held, we think, that the right of action of creditors under these statutes is several, and not joint. Each one has his own demand, and because of the lack of community of interest with other creditors, he can not join with them in the institution and maintenance of a proceeding to secure their several claims. However, back of these statutory provisions, which thus mark out the remedies to be adopted by the creditors of a corporation for the recovery of their demands against its stockholders, lies the constitutional

provision before quoted, which, independently of all legislation upon the subject, must be allowed such self-operative force as the terms employed indicate the framers of the organic law intended it should have. If the legislative enactments are not up to the requirements of the constitution, and if the constitution be self-operative to the ends sought to be reached, this court must carry out the mandate of the organic instrument.

It is evident that if the constitutional provision be self-executing it operates in favor of creditors as a class and collectively, and against stockholders as a class and collectively. If the constitution itself secures dues from corporations through the individual liability of stockholders, it secures them in the interest of all the creditors alike. In such event the provision, being declarative of a rule of general right and of general liability, would of necessity assert itself through the legal forms adapted to its ends. Those ends, being equality of right and equality of liability, could be reached only through the equity procedure of the courts. Although the legislature might rightfully devise a mode of procedure adapted to the end in view, yet, in the lack of such legislative enactment, the constitution, through its self-operative force, would seize upon and appropriate to its purposes such general forms of action as had been already provided for similar cases, and in such event the petition of the plaintiffs in the court below might be maintained. But we are constrained to hold that the constitutional provision in question is not self-operative. It does not execute its own commands, and can only be regarded as a direction to the legislature. As a rule, constitutional provisions, unless expressed in negative form or possessed of negative meaning, are not self-assertive. They usually assume the form of a command to the legislature, and legislative action becomes necessary to give them effect. The one under consideration is an instance of the latter kind. The constitution does not ordain in terms of the present tense the individual liability of stockholders for the debts of corporations, but it ordains it in terms of the future tense. It declares that "dues from corporations shall be secured," etc., not that "dues from corporations are secured." When the constitution declares that a right shall be secured or a thing shall be done, it means that it shall be secured or shall be done by the legislature. In such case the constitution places upon the legislature the obligation to carry out its ordinances by appropriate enactment. \* \* \*

(Citing and quoting from *Farmers' Loan and Trust Co. v. Funk*, 49 Neb. 353,—holding that "stockholders shall be responsible," imports a present liability and so is self-executing, and is different from "dues shall be secured by;" also *Tuttle v. Bank*, 161 Ill. 497, 34 L. R. A. 750; *Marshall v. Sherman*, 148 N. Y. 9, 34 L. R. A. 757, holding the Kansas constitutional provision was not self-executing.)

The statute, as we have seen, provides for no method of equity procedure to secure equality of right among them, nor equality of liability among the stockholders.

It is a general rule, from which, we think, no dissent exists, that if a statute prescribes a special mode of enforcing the individual liability

of the stockholders of corporations, that mode, and that alone, can be pursued. The liability can be enforced in no other way. The decisions on the subject are collected in a note to *Thompson v. Bank* 19 Nev. 103, 3 Am. St. Rep. 797 (s. c. 9 Pac. Rep. 121). These decisions illustrate the general rule that where a statute confers a right, and at the same time prescribes a remedy for its enforcement, the statutory remedy only can be pursued. Notwithstanding the strength with which the above rule has been fortified by the decisions, counsel for defendants in error present for our consideration a number of cases in which the right of the creditors of corporations to resort to equity for the enforcement of their statutory demands against stockholders, and to secure the distribution among them of the stockholders' statutory liability, have been upheld. However, an examination of these cases shows that in none of them had any statutory remedy been provided for the enforcement of the liability in question, and that in all of them the statute declarative of the substantive right (that is, of the right of the creditors to make demand upon the stockholders) likewise declared an equality of right among the creditors. In such respect all these statutes were like the Nebraska constitution above quoted. They declared a present liability in all the stockholders to all the creditors. They were lacking, however, in the matter of an accompanying statutory remedy, and hence, in all the cases called to our attention, the courts held that the remedy in equity was appropriate and available to enforce the equality of right declared by the statute. \* \* \*

(Citing and quoting from *Pollard v. Bailey*, 20 Wall. 520; *Homer v. Henning*, 93 U. S. 228; *Wright v. McCormack*, 17 Ohio St. 86; *Umsted v. Buskirk*, 17 Ohio St. 114; *Bank v. Dillingham*, 147 N. Y. 603; *Thompson v. Bank*, 19 Nev. 103, 3 Am. St. Rep. 808, *note*.)

We have thus far considered this case without regard to the act of 1897, which vests in receivers of insolvent banks a right of action for the enforcement of the statutory liability of stockholders. \* \* \* The receiver, who had been made a defendant to the equitable suit instituted by the creditor, joined in a portion of the plaintiff's prayer for relief. He asked that he be allowed to collect the several sums due from the stockholders in respect of their statutory liability, that he might distribute it among the creditors as an asset of the bank. The order of the court was in accordance with the receiver's answer or cross-petition. Hence, for all purposes, the action, although begun in the name of a creditor for himself and in behalf of the others, may be regarded as though it had been instituted by the receiver under the statute, and in his trust capacity. It can only be maintained by him by giving to the statute a retroactive effect—an effect which will deprive the individual creditors of their right to maintain the proceedings theretofore allowed by law, and in the form theretofore prescribed by statute, or at least delay their doing so for a year. Can this be done? The uniform holding of the courts has been that it can not be done. It can not be done because the relation between the creditors of a corpora-

tion and its stockholders is a relation of contract—not a contract in the ordinary sense of an agreement between two persons who have reduced their engagement to express terms, but a contract which the law implies from the stockholder's willingness to assume the liability imposed by the statute, as evidenced by his stock subscription, and the creditors' willingness to accept the advantage and security allowed to him. \* \* \*

(Citing and quoting from *Hawthorne v. Calef*, 2 Wall. 10; *McDonnell v. Insurance Co.*, 85 Ala. 401; *Barnitz v. Beverly*, 163 U. S. 118, distinguishing *Story v. Furman*, 25 N. Y. 214—presenting a mere change of remedy.)

*Reversed.*

*Note.* See preceding case and note.

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**Sec. 718. Same. 4. Self-executing provisions. When enforceable in other states.**

WHITMAN v. OXFORD NATIONAL BANK.<sup>1</sup>

1900. IN THE SUPREME COURT OF THE UNITED STATES. 176 U. S. Rep. 559-568.

[Action by the National Bank of Oxford, Pennsylvania, brought in the United States Circuit Court for the southern district of New York, against Whitman, to enforce his statutory liability as a shareholder in a Kansas corporation, upon a debt of \$2,000 due by it to the bank. The defendant moved to direct a verdict in his favor, on the ground that the court had no jurisdiction to enforce the Kansas statutory liability; the court overruled the motion, directed a verdict for plaintiff, refused a new trial, and gave judgment for plaintiff. The circuit court of appeals affirmed the decision, and the case was brought to this court by writ of *certiorari*.]

MR. JUSTICE BREWER. By section 1, of article 12, of the constitution of Kansas, a certain definite liability is cast upon each stockholder in other than railway, religious and charitable corporations. This liability is for the dues of the corporation, and to an amount equal to the stock owned by him. The word "dues" is one of general significance, and includes all contractual obligations. Whether broad enough to include liabilities for torts, either before or after judgment, is not a question before us, and upon it we express no opinion. The words "shall be secured," are not merely directory to the legislature to make provision for such liability, but of themselves declare it. To this extent the constitution is self-executing. *Willis v. Mabon*, 48 Minn. 140. The discretion of the legislature extends beyond this, as indicated by the clause "and such other means

<sup>1</sup>Statement abridged, part of opinion omitted.

as shall be provided by law." A failure of the legislature to create courts or prescribe modes of procedure may, it is true, make ineffective this constitutional provision, but does not destroy the liability; nor is it created by the act of the legislature prescribing the mode of its enforcement. This is the obvious meaning of the constitutional provision. "The simplest and most obvious interpretation of a constitution, if in itself sensible, is the most likely to be that meant by the people in its adoption." Lamar, Justice, in *Lake County v. Rollins*, 130 U. S. 662, 671.

But this constitutional provision does not stand alone. The legislature of Kansas has acted on the subject-matter, and the constitution and the statutes are to be taken together, as making one body of law; and it serves no good purpose to inquire what rights and remedies a creditor of a corporation might have or what liabilities would rest upon a stockholder if either constitution or statutes stood alone and unaided by the other.

In section 32 of chapter 23 of the General Statutes of that state, passed before the organization of the corporation referred to, the legislature prescribed the mode of enforcing this constitutional liability, and if such were needed, declared to what extent it could be enforced. It may be either by motion in a case in which judgment has been rendered against the corporation and execution thereon returned unsatisfied, or by a direct action by the plaintiff in such judgment. Neither remedy can be made effectual in the courts of Kansas against a stockholder, unless by due service of process he is brought within the jurisdiction of such courts. *Wilson v. Seligman*, 144 U. S. 41; *Howell v. Manglesdorf*, 33 Kan. 194, 199.

Whatever else may be said about the remedy, it is direct, certain and available to every creditor of a corporation, and leaves to the stockholders the adjustment between themselves of their respective individual shares of the corporate obligations. In view of the present tendency to carry on business through corporate instrumentalities and the freedom from personal liability which attends ordinary corporate action, it can not be said that this limited additional remedy is open to judicial condemnation.

The liability which by the constitution and statutes is thus declared to rest upon the stockholder, though statutory in its origin, is contractual in its nature. It would not be doubted that if the stockholders in this corporation had formed a partnership, the obligations of each partner to the others and to creditors would be contractual, and determined by the general common law in respect to partnerships. If Kansas had provided for partnerships with limited liability, and these parties, complying with the provisions of the statute, had formed such a partnership, it would also be true that their obligations to one another and to creditors would be contractual, although only in the statute was to be found the authority for the creation of such obligations. And it is none the less so when these same stockholders organized a corporation under a law of Kansas, which prescribed the nature of the obligation which each thereby assumed to



the others and to the creditors. While the statute of Kansas permitted the forming of the corporation under certain conditions, the action of these parties was purely voluntary. In other words, they entered into a contract authorized by statute.

Flash v. Conn, 109 U. S. 371, is much in point. In that case a corporation was organized in the state of New York under an act of legislature which contained this provision:

"Section 10. All the stockholders of every company incorporated under this act shall be severally individually liable to the creditors of the company in which they are stockholders, to an amount equal to the amount of stock held by them respectively, for all debts and contracts made by such company, until the whole amount of capital stock fixed and limited by such company shall have been paid in, and a certificate thereof shall have been made and recorded as prescribed in the following section."

An action was brought in Florida against one of the stockholders, and on error to this court it was held that the stockholder was liable, the court saying (p. 377):

"We think the liability imposed by section 10 is a liability arising upon contract. The stockholders of the company are by the section made severally and individually liable, within certain limits, to the creditors of the company for its debts and contracts. Everyone who becomes a member of the company by subscribing to its stock assumes this liability, which continues until the capital stock is all paid up and a certificate of that fact is made, published and recorded."

And again after noticing the rulings of the court of appeals of the state of New York (p. 379):

"If this were a case arising in the state of New York we should, therefore, follow the construction put upon the statute by the courts of that state. The circumstance that the case comes here from the state of Florida should not leave the statute open to a different construction. It would be an anomaly for this court to put one interpretation on a statute in a case arising in New York, and a different interpretation in a case arising in Florida. Our conclusion, therefore, is that this action was not brought to enforce a liability in the nature of a penalty.

"The right of the plaintiffs to sue upon this liability in any court having jurisdiction of the subject-matter and the parties is, therefore, clear. Dennick v. Railroad Co., 103 U. S. 11."

And finally, in reference to the objection that the action was one at law against a single stockholder, instead of in equity against all (p. 380):

"But in this case the statute makes every stockholder individually liable for the debts of the company for an amount equal to the amount of his stock. This liability is fixed, and does not depend on the liability of other stockholders. There is no necessity for bringing in other stockholders or creditors. Any creditor who has recovered judgment against the company and sued out an execution thereon, which has been returned unsatisfied, may sue any stockholder, and no

other creditor can. Such actions are maintained without objection in the courts of New York, under section 10 of the statute relied on in this case. *Shillington v. Howland*, 53 N. Y. 371; *Wiles v. Suydam*, 64 N. Y. 173; *Handy v. Draper*, 89 N. Y. 334; *Rocky Mountain Nat. Bank v. Bliss*, 89 N. Y. 338." \* \* \*

(Citing from *Richmond v. Irons*, 121 U. S. 27; *Concord Bank v. Hawkins*, 174 U. S. 364, 372; *Abbey v. Dry Goods Co.*, 44 Kan. 415, 418; *Plumb v. Bank of Enterprise*, 48 Kan. 484, 486; *Howell v. Manglesdorf*, 33 Kan. 194, 199; *Pierce v. Security Co.*, 60 Kan. 164, to the effect that such statutory liability was of a *contractual nature*.)

And as this liability is one which is contractual in its nature, it is also clear that an action therefor can be maintained in any court of competent jurisdiction. *Derrick v. Railroad Company*, 103 U. S. 11; *Huntington v. Attrill*, 146 U. S. 657.

Similar views have been expressed by the highest courts of several states in like actions based upon the same Kansas constitutional and statutory provisions. *Ferguson v. Sherman*, 116 Cal. 169; *Bell v. Farwell*, 176 Ill. 489; *Hancock National Bank v. Ellis*, 172 Mass. 39; *Western National Bank v. Lawrence*, 117 Mich. 669; *Guerney v. Moore*, 131 Mo. 650. See, also, *Paine v. Stewart*, 33 Conn. 516; *Cushing v. Perot*, 175 Pa. St. 66; *Rhodes v. United States National Bank* (U. S. Ct. App., 7th Cir.), 24 U. S. App. 607; *Bank of North America v. Rindge* (U. S. Cir. Ct. S. Dist. Cal.), 57 Fed. Rep. 279; *McVickar v. Jones* (Cir. Ct. Dist. N. H.), 70 Fed. Rep. 754; *Mechanics' Savings Bank v. Fidelity Insurance Company* (Cir. Ct. E. Dist. Penn.), 87 Fed. Rep. 113; *Dexter v. Edmands* (Cir. Ct. Mass.), 89 Fed. Rep. 467; *Brown v. Trail* (Cir. Ct. Dist. Md.), 89 Fed. Rep. 641.

We see no error in the judgment of the circuit court of appeals, and it is, therefore,

*Affirmed.*

Mr. Justice Peckham dissented.

*Note.* See note, *supra*, p. 2014, and *infra*, pp. 2028, 2033.

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Sec. 719. Same. 5. Enforcement in other states.  
(a) When it will not be enforced.

EDWARD MARSHALL, RESPONDENT, v. GEORGE R. SHERMAN, APPELLANT.<sup>1</sup>

1895. IN THE COURT OF APPEALS OF NEW YORK. 148 N. Y. Rep. 9-29, 51 Am. St. Rep. 654.

[Action brought by the creditor of an insolvent Kansas bank against the defendant to enforce his statutory liability under the Kansas statute. The complaint set forth the facts as to the incorporation of

<sup>1</sup> Statement much abridged; arguments and part of opinion omitted.

the bank, its insolvency, the appointment of a receiver, its dissolution; that debts were left unpaid; that he had recovered judgment against it for \$1,804; execution was returned unsatisfied; that the receiver had paid him \$880, leaving \$924 unpaid, for which he demanded judgment against the defendant. The provisions of the constitution and statutes of Kansas were set forth as follows:

“The provision of the constitution of that state, which is the foundation of the alleged liability, reads as follows: ‘Dues from corporations shall be secured by individual liability of the stockholders to an additional amount equal to the stock owned by such stockholders, and such other means as shall be provided by law; but such individual liability shall not apply to railroad corporations nor corporations for religious and charitable purposes.’ The statutes for the enforcement of this liability enacted by that state, and set forth in the complaint, are embraced in two sections of the laws with respect to the liability of the stockholders in corporations. They are as follows (section 44): ‘If any corporation created under this, or any general statute of this state, except railway or charitable or religious corporations, be dissolved, leaving debts unpaid, suit may be brought against any person or persons who were stockholders at the time of such dissolution, without joining the corporation in such suit; and if judgment be rendered and execution satisfied, the defendant or defendants may sue all who were stockholders at the time of the dissolution for the recovery of the portion of such debt for which they were liable, and the execution upon the judgment shall direct the collection to be made from property of each stockholder respectively; and if any number of the stockholders (defendants in the case) shall not have property enough to satisfy his or their portion of the execution, then the amount of the deficiency shall be divided equally among all the remaining stockholders, and collections made accordingly, deducting from the amount a sum in proportion to the amount of stock owned by the plaintiff at the time the company was dissolved.’

“The other enactment is section 32 and is set forth in the complaint as follows: ‘Execution against stockholders’ action. That if any execution shall have been issued against the property or effects of a corporation, except a railway or a religious or charitable corporation, and there can not be found any property whereon to levy such execution, then execution may be issued against any of the stockholders, to an extent equal in amount to the amount of the stock by him or her owned, together with any amount unpaid thereon; but no execution shall issue against any stockholder except upon an order brought or instituted, made upon motion in open court, after reasonable notice in writing to the person or persons sought to be charged, and upon such motion such court may order execution to issue accordingly, or the plaintiff in the execution may proceed by action to charge the stockholders with the amount of his judgment.’ ”

The defendant demurred on the ground that the complaint showed a defect of parties, in that all stockholders were not made defendants, and that it did not state facts sufficient to constitute the cause of ac-

tion. There was no allegation as to the meaning of the constitution and statutes of Kansas, or that there had been any judgment in that state against the defendant. The demurrer was overruled in the court below.]

O'BRIEN, J. \* \* \* (After stating the facts, and holding that the constitutional provision was not self-executing, proceeds:) The question is thus presented whether a right of action unknown to the common law, and existing only by the force of the statutes of another state, can be enforced in the courts of this state, or outside of the local jurisdiction where the corporation is domiciled. The defendant's relation to the corporation is governed by the laws of the state of its creation, and the general rule is that the statutory liability of stockholders in foreign corporations can not be enforced except at the domicile of the corporation when the law of the domicile provides the remedy. In *Erickson v. Nesmith* (4 Allen 233) the court said: "There seems to be no practicable mode of dealing with such corporations and its members, when seeking to charge the latter upon the statute liability, but to proceed in the manner prescribed by the statute creating such liability, and in the local jurisdiction where the corporation was established and carries on its business, and by whose local statutes alone the responsibility exists." We think that when the statutes set forth in the complaint are carefully read, it is apparent from their language that they provide for a special and peculiar remedy against the stockholders of a corporation created under the laws of that state. From their whole structure and scope it is apparent that they were intended to operate and be enforced only within that jurisdiction. It is quite clear that as to some of their provisions, at least, it would be impossible to enforce them in this state, and they should be construed as enactments *in pari materia*, and as a whole. If it appears that they can not as a whole scheme be given full effect in this state, we ought not to detach some particular provision from the general context with a view of ascertaining whether that is or is not enforceable beyond the local jurisdiction. But without reference to the special and peculiar provisions of these statutes, we think that the general current of authority is to the effect that such enactments are to be enforced only within the jurisdiction of the sovereignty where they exist. Some of the authorities will be referred to hereafter.

The judgment of the learned court below seems to have proceeded principally upon the ground that the liability of the defendant as a stockholder of the insolvent bank in another state is primary and contractual. It is quite doubtful, at least, whether any such relation exists between the stockholders of the corporation and its creditors after the capital stock has been paid in, and the organization of the corporation completed so as to give it legal capacity to make contracts and incur obligations for itself. The statute of this state, as construed by judicial decisions, seems to recognize that relation only in cases of liability before the capital stock is paid in. Up to that time the liability of stockholders has been likened to that of partners engaged

in a joint enterprise, which, however, disappears upon the perfection of the corporate organization. \* \* \*

(Citing and quoting from *First National Bank of Auburn v. Dillingham*, 147 N. Y. 603.) •

The only liability that in law is imposed upon the defendant to pay this debt, or any part of it, is created by the statutes of the state where the corporation is domiciled. The principle adopted, generally, by the more recent cases in this state, is that such a liability is not strictly based upon contract, but is created by statute. It is not primary but secondary, and conditional upon the failure of the corporation itself, which owes the debt, to pay it. A liability is imposed by statute upon the defendant to pay the corporate debts to a limited extent, under certain circumstances and upon certain conditions. It is not a general liability, but special, and conditioned upon the failure of the corporation itself to pay. This peculiar liability has been held by our courts to place the stockholders of the corporation in the relation of sureties or guarantors of the corporate debts, and the obligation is limited in the first place, by the defendant's holdings in the corporation, and in the second place by the deficiency existing after the application of all the property of the corporation to the payment of its debts.

It does not appear from the statements of the complaint that the corporate property which passed into the hands of the receiver has yet been marshalled or appropriated for the benefit of creditors. It does appear that a part of it has, but as to how much, if any, still remains in the hands of the receiver, applicable to the discharge of the obligations held by creditors, the complaint is silent. True, there is the allegation that the corporation is insolvent and has not sufficient property to discharge its debts. But until all the property of the corporation in the hands of the receiver has been appropriated to that purpose it can not be known what the deficiency is which the stockholders are required to make up. If the defendant should pay the plaintiff's debt in this action, for aught that appears some one may still be entitled to a dividend from the receiver on account of it, and until it has been definitely ascertained by some proceeding, legal or equitable, either in the courts of the state where the corporation was domiciled, or here, what the deficiency is, it is impossible to say, with any degree of accuracy, how much the defendant ought to pay. The relations of the defendant as a stockholder of the corporation are fixed and governed by the laws of the state in which the corporation is domiciled and under which it was created. If those laws created a liability against the defendant upon certain conditions and under certain circumstances, they also provided a special and peculiar remedy; and the general trend of authority is to the effect that the remedy thus provided must be followed, and the proceedings for its enforcement must be within the local jurisdiction and by the judicial department of the sovereignty which enacted the law and created the corporation; and this would be so whether the liability is penal in its nature or arises from the implied obligation of defendant by the purchase of

stock. But if, under any circumstances, the action could be maintained in this jurisdiction, it must be in such a form and by such modes of procedure as like liabilities created under our own statutes are enforced against our own citizens.

There is no reason why the plaintiff should be permitted to enforce his debt in this jurisdiction against a citizen of this state in a form of action different from that which a creditor of a domestic corporation may prosecute against a domestic stockholder. It is quite well established that in a case like this an action at law by a single creditor against a single stockholder for the recovery of a specific sum of money can not be maintained in our courts under our statutes declaring the liability of stockholders. In such cases the liability must be enforced in equity in a suit brought by or in behalf of all the creditors against all the stockholders wherein the amount of the liability, and all the equities can be ascertained and adjusted. The stockholders of this Kansas bank are not equitably liable for any greater sum than may be necessary to discharge the debts after the corporate property has been applied. All of them that are solvent should contribute in proportion to the amount of their holdings of stock. We are not informed by the complaint how many stockholders there are, or even the amount of the capital stock. Nor are we informed whether any of the stockholders are insolvent. It is quite evident, therefore, that the equitable proportion of the corporate debts which this defendant should pay can not be ascertained or determined in this action. The liability of the stockholders is a fund to which all the creditors are entitled to resort after the corporate property has been applied upon the debts. If this action can be maintained it is quite apparent that one creditor may collect his debt in full, and another creditor may not be paid anything except what he is able to collect from the corporation.

The statutes upon which this action is based provide, among other things, that when judgment is obtained against a stockholder and it is satisfied by collection or payment, he may, in turn, maintain an action against all the other stockholders, who are such at the time of dissolution, for the recovery of the portion of the debt for which they were liable, and if any stockholder thus sued shall not have property enough to satisfy his portion of the claim, the deficiency shall be divided equally among the remaining stockholders and collected accordingly. It is quite apparent that the purpose of the law can not be carried out, except by a proceeding in equity for an accounting, to which all the stockholders are made parties. If the plaintiff can maintain this action and collect his debts from the defendant, how can the defendant proceed against his fellow-stockholders to reimburse himself for that part of the debt which they should have paid? It would be manifestly unjust and unfair to compel him to pay this claim and turn him over to another action, perhaps in another state, or in many states, in order to obtain the contribution which the law evidently contemplates. All these questions should be settled in one proceeding, or in one action, and that at the domicile of the corporation.



The statute contemplates that each stockholder shall pay his just proportion of any sum that may be required to discharge the outstanding obligations of the corporation. The form of the action should be one, therefore, adapted to the protection of all. A suit at law by one creditor to recover for himself alone is entirely inconsistent with any idea of contribution. The liability is not to any individual creditor, but for contribution to the fund, out of which all creditors are to be paid alike. Hence, the appropriate remedy is by suit in equity to enforce the contribution, and not by one creditor alone to appropriate to his own use that which belongs to others equally with himself. (First National Bank v. Dillingham, 147 N. Y. 603; Terry v. Little, 101 U. S. 216; Hornor v. Henning, 93 U. S. 228.) It is impossible to conceal from ourselves that such is the scope and real purpose of the action, and hence we are asked to enforce a remedy under a foreign law where it is perfectly apparent that complete justice can not be done, and where it is plain that an equitable result can be accomplished only by the courts of the jurisdiction where the corporation was created.

The case has thus far been considered with reference to the discovery of some practical method of applying in this jurisdiction the peculiar local remedy for the enforcement of the statutory liability created by the law of the domicile. There is still another aspect of the question which deserves attention, and it must be viewed in the light of notorious facts which, though not appearing in the record, are matters of current history and common knowledge to which we can not shut our eyes. Within recent years numerous business enterprises have been promoted in some of the western states, the money for the prosecution of which has been to a large extent borrowed here, either in the form of direct loans upon some kind of security, or by inducing many of our citizens to purchase stock in corporations organized for the purpose under local laws. Much of these investments, amounting to a vast sum in the aggregate, has been lost. This result, in some degree, is to be attributed to financial depression and the consequent derangement of business, but in a much greater degree to the gross mismanagement and dishonesty of the managers and promoters. The funds thus procured have been used largely in furtherance of local and private interests and in disregard of every prudent safeguard for the protection of the investors, and sometimes in defiance of every principle of common honesty. In some cases, when the managers well knew they were hopelessly involved, they continued to transact business, borrowing recklessly and pledging the assets in their possession or under their control. When the crash came these assets were sold by the pledgees, and, of course, sacrificed in many cases, leaving large deficiencies, which honest and prudent management could have converted into a surplus. A careful investigation of some of the disastrous failures of loan, investment, trust, land and mortgage companies, as well as banks and other corporations, will reveal this condition of things. It will not be difficult for speculators to purchase large claims against these defunct corporations at a very low price, if

they can be readily enforced here against stockholders who have made and lost investments in the stock.

These considerations are not, of course, pertinent in a case where a party is seeking to enforce a clear legal right, whatever may have been the circumstances of its origin, but they serve to stimulate a careful inquiry as to the principles and reasons upon which the courts of this state are required to aid in the enforcement of claims of this character.

In the case at bar the plaintiff's right of action has no other legal or moral basis than the *fiat* of a legislature of another state. It is a principle of universal application, recognized in all civilized states, that the statutes of one state have, *ex proprio vigore*, no force or effect in another. The enforcement in our courts of some positive law or regulation of another state depends upon our own express or tacit consent. The consent is given only by virtue of the adoption of the doctrine of comity as a part of our municipal law. That doctrine has many limitations and qualifications, and generally each sovereignty has the right to determine for itself its true scope and extent. The courts of this state are open to all suitors to enforce rights of action, transitory in their nature, recognized by the common law or founded in natural justice, and when no law of the forum or any principle of public policy interferes. There is, however, a large class of foreign laws and statutes which, under the doctrine of comity, have no force in this jurisdiction. It belongs exclusively to each sovereignty to determine for itself whether it can enforce a foreign law without, at the same time, neglecting the duty that it owes to its own citizens or subjects. \* \* \*

(Citing cases to the effect that the courts of one state would not enforce the revenue, exemption, penal and bankrupt laws, and statutes of frauds of other states; also citing the following cases where states had refused to enforce the statutory liability of shareholders in the foreign corporations: *Derrickson v. Smith*, 27 N. J. L. 166; *New Haven Horse & N. Co. v. Linden Spring Co.*, 142 Mass. 349; *Post v. T. C., etc., Ry. Co.*, 144 Mass. 341; *Bank of North Am. v. Rindge*, 154 Mass. 203; *Fowler v. Lamson*, 146 Ill. 472; *Young v. Farwell*, 139 Ill. 326; *May v. Black*, 77 Wis. 101; *Nimick v. Mingo Iron Work Co.*, 25 W. Va. 184, on the ground that the remedy was peculiar and exclusive; *Terry v. Little*, 101 U. S. 216; *National Tube Works Co. v. Ballou*, 146 U. S. 517; *Pollard v. Bailey*, 20 Wall. 520; *Fourth National Bank v. Francklyn*, 120 U. S. 747; *Peck v. Miller*, 39 Mich. 594; *Barrick v. Gifford*, 47 Ohio St. 181; *Allen v. Walsh*, 25 Minn. 543; *Smith v. Huckabee*, 53 Ala. 191, on the ground that the remedy should be in equity after all remedies against the corporation are exhausted.)

It would, perhaps, be impossible to state the principle upon which the decision should rest, without apparently coming in conflict with some of the numerous cases on the subject at some point. The great weight of authority, as will be seen, is against the right to maintain such an action. Sometimes the decision is put upon one ground, and sometimes upon another, but it is to be noticed that the party seeking to enforce such a statute in a foreign jurisdiction has

with the policy of the state or impair the rights of its own citizens." (Mabon v. Ongley Electric Co., 156 N. Y. 196, 201.) This is made very plain by the learned opinion of the appellate division, which leaves nothing to be said upon the subject. (Howarth v. Angle, 39 App. Div. 151.)

It was not necessary that all the stockholders should be before the Washington court when the order was made appointing the plaintiff receiver and giving him authority to sue any more than when a decree in bankruptcy is made, which binds all who are not parties the same as those who are. (Sanger v. Upton, 91 U. S. 56.) That judgment may be regarded as a proceeding *in rem*, binding upon all the world so far as title to the assets of the corporation is concerned, and, according to the decisions of the highest court of the state where it was made, the so-called statutory liability of stockholders is a part of the assets.

The defendant took stock in the Tacoma bank subject to the burden of the law, which he impliedly agreed to bear, as he could not otherwise have become a stockholder. (Lowry v. Inman, 46 N. Y. 119.) That burden is an asset, vested in the receiver, and can be enforced in this state the same as a promissory note, not because the laws of Washington are in force here, but because the defendant voluntarily assented to the conditions upon which the bank was organized. As was said in the case last cited: "A personal liability of stockholders for the debts of a corporation, in virtue of the charter, is not in the nature of a penalty or forfeiture, and does not exist solely as a liability imposed by statute. It is not enforced simply as a statutory obligation, but is regarded as voluntarily assumed by the act of becoming a stockholder. \* \* \* It is like other obligations, assumed in the form prescribed by the laws of the place where made, and being valid there, is enforceable everywhere. Its validity, interpretation and effect are to be determined by the *lex loci*, but the remedy is governed by the *lex fori*." While the liability is, for convenience, frequently called statutory, because the statute, which is the constitution of the bank, affixed the obligation to the ownership of stock, it is in fact contractual and springs from an implied promise. There is no substantial difference between the liability for an unpaid balance on a stock subscription, which is an express contract to take stock and pay for it (Stoddard v. Lum, 159 N. Y. 265), and the liability for the unpaid deficiency of assets assumed by the act of becoming a member of the corporation through the purchase of stock, from which a contract is implied to perform the statutory conditions upon which stock may be owned. (Richmond v. Irons, 121 U. S. 27, 55.) The fact that the former is the promise of a principal and the latter of a surety does not affect the question. The express promise runs to the corporation, and may be enforced by it, while the implied promise runs to the creditors, and may, according to the common law of the state where it was made, be enforced for the benefit of creditors by a receiver of the corporation appointed to wind up its affairs. The latter

promise is not a part of the capital stock of the bank, but is a substitute, required by statute, for the personal liability of a partner at common law, and has the same object, which is the protection of creditors.

The stockholders, however, may controvert in our courts all the essential facts, such as insolvency, the amount of the deficiency, and the like, whether they are established by the judgment appointing the receiver or not. They may require strict common-law proof as to all the facts upon which the deficiency is based, and may contest any unreasonable expenditure in the conversion of assets and the collection of accounts, including extravagant allowances to attorneys or counsel. Upon all these questions the defendant has had his day in the courts of this state, and the united action of the courts below have conclusively determined them against him.

If the statute, upon which the personal liability of the stockholders is founded, had also provided a remedy for that liability, such remedy would have been exclusive and could not have been enforced in the courts of this state. It was said in *Pollard v. Bailey* (87 U. S. 520, 527), "the liability and the remedy were created by the same statute. This being so, the remedy provided is exclusive of all others. A general liability created by a statute without a remedy may be enforced by an appropriate common-law action." The statute of Washington, however, provided no remedy, but left that subject to the courts, to be worked out according to the common law. The learned counsel for the appellant recognizes the distinction between foreign statutes which create a liability and provide a remedy and those which create a liability but do not provide a remedy. He admits that, according to the law of this state, in the former class only the remedy provided by the foreign statute can be pursued, while in the latter it depends upon interstate comity. He insists, however, that the procedure against resident stockholders of a foreign corporation must be in substantial accordance with the practice established in the state where the action is brought, and this is true to the extent that no departure from that practice is permitted, which results in injustice to the citizens of that state or is against the public policy thereof. He relies upon the case of *Marshall v. Sherman* (148 N. Y. 9), where the action was not brought by a receiver, but by a creditor of an insolvent bank in Kansas, to recover the amount of a deposit after a receiver had been appointed in that state. The action was founded upon a local statute, which not only created the liability, but also provided a peculiar and complicated remedy unknown to our courts, and which could not be entirely enforced in this state. (*Lowry v. Inman*, 46 N. Y. 119; *Christensen v. Eno*, 106 N. Y. 97, 103). The liability was neither contractual, in the general sense, nor penal, but the statute charged the property of the stockholder with the debts of the insolvent corporation to the extent of the stock held by him. It was the case so aptly described by Judge Allen, in *Lowry v. Inman* (*supra*), where the intent of the legislature "was not to create a general, per-

sonal or property liability, but to charge the property of the stockholders, and that not generally, or by the usual and ordinary process, but conditionally, and by a peculiar and unusual procedure, only available in the courts of that state, not only limiting and prescribing the security and rights of the creditor, and the obligation and liability of the stockholder, but prescribing the remedy going with it, and as a part of the right." \* \* \*

In that case<sup>1</sup> the amount of the deficiency was not ascertained in any way by a court or otherwise; the action was not brought by a receiver; the remedy sought was that provided by the foreign statute which created the liability; that remedy could not be wholly enforced in this state, and, to the extent that it could be enforced, might result in injustice to our citizens. In this case the action is brought by a receiver, who, according to the decision of the Washington courts, has the title to the right of action, and the amount of the deficiency has been definitely ascertained both by the courts of that state and of this. It does not appear that there is any other stockholder or any creditor in this state, or that injustice will be done to any citizen of this state, by sustaining the judgment appealed from. The reasons given by the court for denying relief in *Marshall v. Sherman* are met by the facts of this case, which distinguish it in many essential respects and permit a recovery under the principles sanctioned, but not applied, in that case, because the necessary facts were wanting. \* \* \*

It is sufficient if the method of procedure in our courts is such that no injustice is done to the defendant, or to any citizen of this state, and the established policy of the state is not interfered with. (*Willits v. Waite*, 25 N. Y. 577, 585.) No injustice was done the defendant by the judgments below, because he was only required to pay his exact proportion of the deficiency, as duly ascertained by the courts of this state. The fact that the deficiency had also been ascertained by the courts in Washington and the same amount found to exist did no harm. There is no inequality, for one creditor is not paid in full, while others get less, but all are benefited equally, and no one gets more than his due. Justice is done to all and injustice to none. While only a single stockholder was made a party to the action, he was the only stockholder, so far as appears, who could be served in this state.

If some of the stockholders should prove insolvent, the defendant can not be affected by it or his liability increased thereby. Under the Federal banking law, which contains the same provision as to the liability of stockholders, in the same words as the statute in question, it was held that there was no power to direct a second assessment to supply the deficit caused by the inability of the receiver to enforce payment from such stockholders as were insolvent or beyond the jurisdiction. It was also held that the effect of the words "equally and ratably and not one for another," was to make the liability several and not joint, and to protect each stockholder from liability for the

<sup>1</sup> *Marshall v. Sherman*.



default of another. It was distinctly announced "that the shareholders were not intended to be put in the relation of guarantors or sureties one for another, as to the amount which each might be required to pay," and that "the insolvency of one stockholder, or his being beyond the jurisdiction of the court, does not in anywise affect the liability of another." (United States v. Knox, 102 U. S. 422. See, also, Matter of the Hollister Bank, 27 N. Y. 393; Crease v. Babcock, 10 Metc. 525, and Morse on Banking, 503.) \* \* \* When an action by a foreign receiver to collect assets, under the authority of the court which appointed him, works no detriment to any citizen of this state, and is not repugnant to its policy, it would be a provincial and narrow view for our courts to refuse to extend the usual state comity. There is a close business connection between the citizens of the different states of the Union. Investments are freely made in other states by the citizens of this state, who need the aid of the courts of the jurisdiction where the investments are made. The comity which we expect to have extended to citizens of our state, we can not, in justice, refuse to citizens of other states. State lines should not prevent justice from being done. Our courts should not close their doors to a receiver from another state, who comes here, armed with a title to a just claim against a citizen of this state, and offers to establish by common-law evidence the liability of that citizen. While we should keep control of the subject, so as to see that no discrimination is practiced against our citizens, or injustice done them, either as to the substance of the liability or the method of procedure, when the same result is attained in practically the same way as, under similar circumstances, would be attained in the case of a domestic corporation, there is no reason for withholding that aid which is now afforded by the courts of almost all enlightened countries.

The judgment should be affirmed, with costs.

Parker, C. J., Bartlett, Haight, Martin and Landon, JJ., concur; O'Brien, J., not voting.

*Judgment affirmed.*

*Note. When enforceable in other states.* See, 1883, Flash v. Conn, 109 U. S. 371; 1893, Aldrich v. Anchor, etc., Coal Co., 24 Ore. 32, 41 Am. St. Rep. 831, note; 1895, Mandel v. Swan Cattle Co., 154 Ill. 177, 45 Am. St. Rep. 124, note 132; 1896, Hancock Nat'l Bank v. Ellis, 166 Mass. 414, 55 Am. St. Rep. 414; 1898, Hancock Nat'l Bank v. Ellis, 172 Mass. 39, 70 Am. St. Rep. 232, 42 L. R. A. 396; 1899, Fidelity Ins. T. & S. D. Co. v. Mechanics, etc., Bank, 97 Fed. Rep. 297 (C. C. A. Pa.); 1900, Howarth v. Lombard, 175 Mass. 570, 49 L. R. A. 301, 56 N. E. Rep. 888; 1901, Bank of China v. Morse, 168 N. Y. 458, 56 L. R. A. 139; 1902, Blair v. Newbegin, 65 O. S. 425, 58 L. R. A. 644.

See preceding case and note.

## Sec. 721. Same. (c) Penal liability.

See Huntington v. Attrill, 146 U. S. 657, *supra*, p. 1892.



## II. RIGHTS OF SHAREHOLDERS.

**Sec. 722.** 1. To receive dividends from profits earned.

See, *supra*, §§ 543-549.

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**Sec. 723.** 2. To keep dividends received in good faith, though paid out of capital when solvent.

See *McDonald v. Williams*, 174 U. S. 397, *supra*, p. 1981, and note, p. 1985, *Lawrence v. Greenup*, 97 Fed. Rep. 906, *supra*, p. 1985.

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**Sec. 724.** 3. To be released from liability.  
(a) By fraud in securing subscription.

See *Martin v. South Salem, etc., Co.*, 94 Va. 28, *supra*, p. 539; *Upton v. Englehart*, 3 Dill. 496, *supra*, p. 1559.

*Note.* Compare, 1859, *Ogilvie v. Knox Ins. Co.*, 22 How. 380. See note, *supra*, p.

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**Sec. 725.** Same. (b) By forfeiture of shares for non-payment.

See *Small v. The Herkimer Mfg. Co.*, 2 N. Y. 330, *supra*, p. 1567.

*Note.* See, 1896, *Burt v. Real Estate Exchange*, 175 Pa. St. 619, 52 Am. St. Rep. 858.

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**Sec. 726.** Same. (c) By acceptance, by the corporation, of a material amendment, when not assented to by the shareholder.

See *Ashton v. Burbank*, 2 Dill. 435, *supra*, p. 87; *Railway Co. v. Allerton*, 18 Wall. 233, *supra*, p. 442; *Clearwater v. Meredith*, 1 Wall. 25, *supra*, p. 984; *Buffalo & N. Y. C. Ry. v. Dudley*, 14 N. Y. 336, *supra*, p. 1461; *Stevens v. Rutland, etc., R. Co.*, 29 Vt. 545, *supra*, p. 1448; *Durfee v. Old Colony R.*, 5 Allen 230, *supra*, p. 1462; *Zabriskie v. Hackensack, etc., R. Co.*, 18 N. J. Eq. 178, *supra*, p. 1466; note, *supra*, p. 1472.

*Note.* See, also, 1824, *Natusch v. Irving, Gow. Partnership App.*, vi, p. 398; 1843, *Hartford & N. H. R. v. Croswell*, 5 Hill 383; 1863, *Kenosha R. & R. I. R. v. Marsh*, 17 Wis. 13; 1873, *Nugent v. The Supervisors*, 19 Wall. 241; 1876, *Memphis B. R. Co. v. Sullivan*, 57 Ga. 240.

Compare, 1895, *Greenbrier Indus. Exp. v. Squires*, 40 W. Va. 307, 52 Am. St. Rep. 884.

Sec. 727. (d) By completed transfer of shares.

See *supra*, §§ 566–568.

*Note.* See, also, 1889, *Foster v. Row*, 120 Mich. 1, 77 Am. St. Rep. 585; 1900, *Wick Nat'l Bk. v. Union Nat'l Bk.*, 62 Ohio St. 446, 78 Am. St. Rep. 734.

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## SUBDIVISION V. RIGHTS OF CORPORATE CREDITORS AMONG THEMSELVES.

### ARTICLE I. PRIORITY.

Sec. 728. 1. In general by promptness of action.

See *Louisville, N. A. & C. Ry. Co. v. Boney*, 117 Ind. 501, *supra*, p. 1842; *Allen v. Montgomery R. Co.*, 11 Ala. 437, *supra*, p. 1960; *First Nat'l Bank v. Peavey*, 69 Fed. Rep. 455, *supra*, p. 1962.

*Note.* See note, 3 Am. St. Rep. 806, 869.

See, 1901, *Merchants Natl. Bank v. McDonald*, — Neb. —, 88 N. W. 492.

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Sec. 729. 2. In case of unpaid subscriptions, or withdrawal of assets.

See *Allen v. Montgomery R. Co.*, 11 Ala. 437, *supra*, p. 1960; *Hatch v. Dana*, 101 U. S. 205, *supra*, p. 1965; *Lawrence v. Greenup*, 97 Fed. Rep. 906, *supra*, p. 1985.

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Sec. 730. 3. In case of statutory liability of shareholders or officers.

See *supra*, §§ 707, 709, 713, 717.

*Note.* See note, 3 Am. St. Rep. 869.

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Sec. 731. 4. By voluntary preference by corporation.  
(a) General creditors.

See *Catlin v. Eagle Bank*, 6 Conn. 233, *supra*, p. 1815; *Rouse v. Merchants' Nat'l Bank*, 46 Ohio St. 493, *supra*, p. 1819.

**Sec. 732. Same. (b) Director-creditors.**

See *Olney v. Conanicut Land Co.*, 16 R. I. 597, *supra*, p. 1832; *Howe, Brown & Co. v. Sanford F. & T. Co.*, 44 Fed. Rep. 231, *supra*, p. 1835; *Corey v. Wadsworth*, 118 Ala. 489, *supra*, p. 1836.

**Sec. 733. 5. By statutory provisions. Resident and non-resident creditors.**

(a) Natural and artificial non-resident persons as creditors.

**BLAKE v. McCCLUNG.<sup>1</sup>**

1898. IN THE SUPREME COURT OF THE UNITED STATES. 172 U. S. Rep. 239-269.

[In 1893, McClung & Co., residents of Tennessee, filed a creditor's bill in the Tennessee courts against the Embreeville Company, a British mining and manufacturing company authorized to do, and doing, business in Tennessee from an office established there, alleging insolvency of the company and fraudulent preferences made by it, contrary to the laws of Tennessee. The home office was in London, and after suit was begun in Tennessee, liquidation proceedings under the English law were begun there. The Tennessee court appointed a receiver of the property in Tennessee, administered its affairs there, and adjudicated the rights and priorities of creditors, including claims of debenture holders to amount of \$125,000, and trade claims to amount of \$90,000—both owned by non-residents of the United States; also the claims of Blake, and of Rogers & Co., residents of Ohio, and of the Hull Coal Company, a Virginia corporation—all of whom had intervened in the original suit, alleging that McClung & Co. claimed priority of right over "citizens of the United States, but not of the state of Tennessee," according to certain statutes of Tennessee, which were alleged to violate the national constitution.

The court held the law constitutional, and held that the Tennessee creditors were entitled to *priority* (with certain exceptions, not important here) over other creditors, "residents and *citizens of other states* of the United States or other countries;" that the creditors who were "citizens of other states" of the United States are entitled to share ratably in its assets being administered in this cause, next after the payment of the Tennessee creditors. This decision, in these particulars, was affirmed by the court of chancery appeals, and finally by the supreme court of Tennessee. Plaintiff obtained this writ of error. The statute complained of provides that any foreign corporation may become incorporated in Tennessee, and do business there by filing a copy of its charter in the office of its secretary of state, whereupon it

<sup>1</sup> Statement abridged. Part of opinion omitted; also the dissenting opinion of Mr. Justice Brewer, C. J. Fuller concurring, is omitted.

shall be deemed and taken to be a corporation of that state; and that such corporation and all its property "shall be liable for all the debts, liabilities and engagements of the said corporation, to be enforced in the manner provided by law, for the application of the property of natural persons to the payment of their debts, engagements and contracts. Nevertheless, creditors who may be *residents of this state* shall have a *priority in the distribution of assets*, or subjection of the same, or any part thereof, to the payment of debts over all simple contract creditors, being residents of *any other country* or countries."']

MR. JUSTICE HARLAN. \* \* \* The plaintiffs in error contend that the judgment of the state court, based upon the statute, denies to them rights secured by the second section of the fourth article of the constitution of the United States providing that "the citizens of each state shall be entitled to all privileges and immunities of citizens in the several states," as well as by the first section of the fourteenth amendment, declaring that no state shall "deprive any person of life, liberty or property without due process of law," nor "deny to any person within its jurisdiction the equal protection of the laws." \* \* \*

(After holding that the words, "residents of this state," and "residents of any other country or countries," as used in the act, made it plain that "the state did not intend to place creditors citizens of other states upon an equality with creditors citizens of Tennessee," and that "the manifest purpose was to give to all Tennessee creditors priority over all creditors residing out of that state, whether the latter were *citizens* or only residents of some other state or country.")

We must therefore consider whether the statute infringes rights secured to the plaintiffs in error, citizens of Ohio, by the provision of the second section of article 4 of the constitution of the United States, declaring that the citizens of each state shall be entitled to all privileges and immunities of citizens in the several states.

Beyond question a state may, through judicial proceedings, take possession of the assets of an insolvent foreign corporation within its limits, and distribute such assets or their proceeds among creditors according to their respective rights. But may it exclude citizens of other states from such distribution until the claims of its own citizens shall have been first satisfied? In the administration of the property of an insolvent foreign corporation by the courts of the state in which it is doing business, will the constitution of the United States permit discrimination against individual creditors of such corporations because of their being citizens of other states, and not citizens of the state in which such administration occurs? \* \* \*

This court has never undertaken to give any exact or comprehensive definition of the words "privileges and immunities," in article 4 of the constitution of the United States. Referring to this clause, Mr. Justice Curtis, speaking for the court, in *Conner v. Elliott*, 18 How. 591, 593, said: "We do not deem it needful to attempt to define the meaning of the word *privileges* in this clause of the constitution. It is safer, and more in accordance with the duty of a judicial tribunal,

to leave its meaning to be determined, in each case, upon a view of the particular rights asserted and denied therein." \* \* \*

One of the leading cases in which the general question has been examined is *Corfield v. Coryell*, decided by Mr. Justice Washington at the circuit. He said: "The inquiry is, what are the privileges and immunities of citizens in the several states? We feel no hesitation in confining these expressions to those privileges and immunities which are, in their nature, *fundamental*; which belong, of right, to the citizens of all free governments, and which have, at all times, been enjoyed by the citizens of the several states which compose this Union from the time of their becoming free, independent and sovereign. What these fundamental principles are, it would perhaps be more tedious than difficult to enumerate. They may, however, be comprehended under the following general heads: Protection by the government; the enjoyment of life and liberty, with the right to acquire and possess property of every kind, and to pursue and obtain happiness and safety; subject, nevertheless, to such restraints as the government may justly prescribe for the general good of the whole. The right of a citizen of one state to pass through or to reside in any other state for the purposes of trade, agriculture, professional pursuits or otherwise; to claim the benefit of the writ of *habeas corpus*; to institute and maintain actions of any kind in the courts of the state; to take, hold and dispose of property, either real or personal; and an exemption from higher taxes or impositions than are paid by the other citizens of the state, may be mentioned as some of the particular privileges and immunities of citizens, which are clearly embraced by the general description of privileges deemed to be fundamental; to which may be added the elective franchise, as regulated and established by the laws or constitution of the state in which it is to be exercised. These, and many others which might be mentioned, are, strictly speaking, privileges and immunities, and the enjoyment of them by the citizens of each state in every other state was manifestly calculated (to use the expression of the preamble to the corresponding provision in the old articles of confederation) 'the better to secure and perpetuate mutual friendship and intercourse among the people of the different states of the Union.'" 4 Wash. C. C. 371, 380.

(Quoting from *McCready v. Virginia*, 94 U. S. 391, 395; *Paul v. Virginia*, 8 Wall. 168, 180.) \* \* \*

*Ward v. Maryland*, 12 Wall. 418, 430, involved the validity of a statute of Maryland requiring all traders, not being permanent residents of the state, to take out licenses for the sale of goods, wares and merchandise in Maryland, other than agricultural products and articles there manufactured. This court said: "Attempt will not be made to define the words 'privileges and immunities,' or to specify the rights which they are intended to secure and protect, beyond what may be necessary to the decision of the case before the court. Beyond doubt, those words are words of very comprehensive meaning, but it will be sufficient to say that the clause plainly and unmistakably secures and protects the right of a citizen of one state to pass into any

other state of the Union for the purpose of engaging in lawful commerce, trade or business without molestation; to acquire personal property; to take and hold real estate; to maintain actions in the courts of the state, and to be exempt from any higher taxes or excises than are imposed by the state upon its own citizens. Comprehensive as the power of the states is to lay and collect taxes and excises, it is nevertheless clear, in the judgment of the court, that the power can not be exercised to any extent in a manner forbidden by the constitution; and inasmuch as the constitution provides that the citizens of each state shall be entitled to all privileges and immunities of citizens in the several states, it follows that the defendant might lawfully sell, or offer or expose for sale, within the district described in the indictment, any goods which the permanent residents of the state might sell, or offer or expose for sale, in that district, without being subjected to any higher tax or excise than that exacted by law of such permanent residents." (Quoting from *Slaughter-house Cases*, 16 Wall. 36, 77; *Cole v. Cunningham*, 133 U. S. 107, 113, 114.) \* \* \*

These principles have not been modified by any subsequent decision of this court.

The foundation upon which the above cases rest can not, however, stand, if it be adjudged to be in the power of one state, when establishing regulations for the conduct of private business of a particular kind, to give its own citizens essential privileges connected with that business which it denies to citizens of other states. By the statute in question, the British company was to be deemed and taken to be a corporation of Tennessee, with authority to carry on its business in that state. It was the right of citizens of Tennessee to deal with it, as it was their right to deal with corporations created by Tennessee. And it was equally the right of citizens of other states to deal with that corporation. The state did not assume to declare, even if it could legally have declared that that company, being admitted to do business in Tennessee, should transact business only with citizens of Tennessee or should not transact business with citizens of other states. No one would question the right of the individual plaintiffs in error, although not residents of Tennessee, to sell their goods to that corporation upon such terms in respect of payment as might be agreed upon, and to ship them to the corporation at its place of business in that state. But the enjoyment of these rights is materially obstructed by the statute in question; for that statute, by its necessary operation, excludes citizens of other states from transacting business with that corporation upon terms of equality with citizens of Tennessee. By force of the statute alone, citizens of other states, if they contracted at all with the British corporation, must have done so subject to the onerous condition that if the corporation became insolvent its assets in Tennessee should first be applied to meet its obligations to residents of that state, although liability for its debts and engagements was "to be enforced in the manner provided by law for the application of the property of natural persons to the payment of their debts, engagements and contracts." But, clearly, the state



could not in that mode secure exclusive privileges to its own citizens in matters of business. If a state should attempt, by statute regulating the distribution of the property of insolvent individuals among their creditors, to give priority to the claims of such individual creditors as were citizens of that state over the claims of individual creditors, citizens of other states, such legislation would be repugnant to the constitution upon the ground that it withheld from citizens of other states as such, and because they were such, privileges granted to citizens of the state enacting it. Can a different principle apply, as between individual citizens of the several states, when the assets to be distributed are the assets of an insolvent private corporation lawfully engaged in business and having the power to contract with citizens residing in states other than the one in which it is located?

It is an established rule of equity that when a corporation becomes insolvent it is so far civilly dead that its property may be administered as a trust fund for the benefit of its stockholders and creditors (*Graham v. Railroad Co.*, 102 U. S. 148, 161), not simply of stockholders and creditors residing in a particular state, but all stockholders and creditors, of whatever state they may be citizens. In *Wabash, St. Louis, etc., Railway Co. v. Ham*, 114 U. S. 587, 594, it was said that the property of a corporation was a trust fund for the payment of its debts, in the sense that when the corporation was lawfully dissolved and all its business wound up, or when it was insolvent, all its creditors were entitled in equity to have their debts paid out of the corporate property before any distribution thereof among the stockholders. In *Hollins v. Brierfield Coal and Iron Co.*, 150 U. S. 371, 385, it was observed that a private corporation, when it becomes insolvent, holds its assets subject to somewhat the same kind of equitable lien and trust in favor of its creditors that exists in favor of the creditors of a partnership after becoming insolvent, and that in such case a lien and trust will be enforced by a court of equity in favor of creditors. These principles obtain, no doubt, in Tennessee, and will be applied by its courts in all appropriate cases between citizens of that state, without making any distinction *between them*. Yet the courts of that state are forbidden, by the statute in question, to recognize the right in equity of citizens residing in other states to participate upon terms of equality with citizens of Tennessee in the distribution of the assets of an insolvent foreign corporation lawfully doing business in that state.

We hold such discrimination against citizens of other states to be repugnant to the second section of the fourth article of the constitution of the United States, although, generally speaking, the state has the power to prescribe the conditions upon which foreign corporations may enter its territory for purposes of business. Such a power can not be exerted with the effect of defeating or impairing rights secured to citizens of the several states by the supreme law of the land. Indeed, all the powers possessed by a state must be exercised consistently with the privileges and immunities granted or protected by the constitution of the United States. \* \* \*

(Citing and quoting from *Lafayette Ins. Co. v. French*, 18 How. 404, 407; *Barron v. Burnside*, 121 U. S. 186, 200; *Barrow Steamship Co. v. Kane*, 170 U. S. 100, 111.)

We must not be understood as saying that a citizen of one state is entitled to enjoy in another state *every* privilege that may be given in the latter to its own citizens. There are privileges that may be accorded by a state to its own people, in which citizens of other states may not participate except in conformity to such reasonable regulations as may be established by the state. For instance, a state can not forbid citizens of other states from suing in its courts, that right being enjoyed by its own people; but it may require a non-resident, although a citizen of another state, to give bond for costs, although such bond be not required of a resident. Such a regulation of the internal affairs of a state can not reasonably be characterized as hostile to the fundamental rights of the citizens of other states. So a state may, by rule uniform in its operation as to citizens of the several states, require residence within its limits for a given time before a citizen of another state who becomes a resident thereof shall exercise the right of suffrage or become eligible to office. It has never been supposed that regulations of that character materially interfered with the enjoyment by citizens of each state of the privileges and immunities secured by the constitution to citizens of the several states. The constitution forbids only such legislation affecting citizens of the respective states as will substantially or practically put a citizen of one state in a condition of alienage when he is within or when he removes to another state, or when asserting in another state the rights that commonly appertain to those who are part of the political community known as the people of the United States, by and for whom the government of the Union was ordained and established.

Nor must we be understood as saying that a state may not, by its courts, retain within its limits the assets of a foreign corporation, in order that justice may be done to its own citizens; nor, by appropriate action of its judicial tribunals, see to it that its own citizens are not unjustly discriminated against by reason of the administration in other states of the assets thereof of an insolvent corporation doing business within its limits. For instance, if the Embreeville Company had property in Virginia at the time of its insolvency, the Tennessee court administering its assets in that state could take into account what a Virginia creditor, seeking to participate in the distribution of the company's assets in Tennessee, had received or would receive from the company's assets in Virginia, and make such order touching the assets of the company in Tennessee as would protect Tennessee creditors against wrongful discrimination arising from the particular action taken in Virginia for the benefit of creditors residing in that commonwealth.

It may be appropriate to observe that the objections to the statute of Tennessee do not necessarily embrace enactments that are found in some of the states requiring foreign insurance corporations, as a condition of their coming into the state for purposes of business, to

deposit with the state treasurer funds sufficient to secure policy-holders in its midst. Legislation of that character does not present any question of discrimination against citizens forbidden by the constitution. Insurance funds set apart in advance for the benefit of home policy-holders of a foreign insurance company doing business in the state are a trust fund of a specific kind to be administered for the exclusive benefit of certain persons. Policy-holders in other states know that those particular funds are segregated from the mass of property owned by the company, and that they can not look to them to the prejudice of those for whose special benefit they were deposited. The present case is not one of that kind. The statute of Tennessee did not make it a condition of the right of the British corporation to come into Tennessee for purposes of business that it should, at the outset, deposit with the state a fixed amount, to stand exclusively or primarily for the protection of its Tennessee creditors. It allowed that corporation, after complying with the terms of the statute, to conduct its business in Tennessee as it saw fit, and did not attempt to impose any restriction upon its making contracts with or incurring liabilities to citizens of other states. It permitted that corporation to contract with citizens of other states, and then, in effect, provided that all such contracts should be subject to the condition (in case the corporation became insolvent) that creditors residing in other states should stand aside, in the distribution by the Tennessee courts of the assets of the corporation, until creditors residing in Tennessee were fully paid—not out of any funds or property specifically set aside as a trust fund, and at the outset put into the custody of the state, for the exclusive benefit, or for the benefit primarily, of Tennessee creditors, but out of whatever assets of any kind the corporation might have in that state when insolvency occurred. In other words, so far as Tennessee legislation is concerned, while this corporation could lawfully have contracted with citizens of other states, those citizens can not share in its general assets upon terms of equality with citizens of that state. If such legislation does not deny to citizens of other states, in respect of matters growing out of the ordinary transactions of business, privileges that are accorded to it by citizens of Tennessee, it is difficult to perceive what legislation would effect that result.

We adjudge that when the general property and assets of a private corporation, lawfully doing business in a state, are in course of administration by the courts of such state, creditors who are citizens of other states are entitled, under the constitution of the United States, to stand upon the same plane with creditors of like class who are citizens of such state, and can not be denied equality of right simply because they do not reside in that state, but are citizens residing in other states of the Union. The individual plaintiffs in error were entitled to contract with this British corporation, lawfully doing business in Tennessee, and deemed and taken to be a corporation of that state, and no rule in the distribution of its assets among creditors could be applied to them as resident citizens of Ohio, and because they were not

residents of Tennessee, that was not applied by the courts of Tennessee to creditors of like character who were citizens of Tennessee.

As to the plaintiff in error, the Hull Coal and Coke Company, of Virginia, different considerations must govern our decision. It has long been settled that, for purposes of suit by or against it in the courts of the United States, the members of a corporation are to be conclusively presumed to be citizens of the state creating such corporation; *Louisville, Cincinnati and Charleston Railroad Co. v. Letson*, 2 How. 497; *Covington Drawbridge Co. v. Shepherd, etc.*, 20 How. 227, 232; *Ohio and Mississippi Railroad Co. v. Wheeler*, 1 Black 286, 296; *Steamship Co. v. Tugman*, 106 U. S. 118, 120; *Barrow Steamship Co. v. Kane*, 170 U. S. 100; and, therefore, it has been said that a corporation is to be deemed, for such purposes, a citizen of the state under whose laws it was organized. But it is equally well settled, and we now hold, that a corporation is not a citizen within the meaning of the constitutional provision that "the citizens of each state shall be entitled to all privileges and immunities of citizens in the several states." *Paul v. Virginia*, 8 Wall. 168, 178, 179; *Ducat v. Chicago*, 10 Wall. 410, 415; *Liverpool Ins. Co. v. Massachusetts*, 10 Wall. 566, 573. The Virginia corporation, therefore, can not invoke that provision for protection against the decree of the state court denying its right to participate upon terms of equality with Tennessee creditors in the distribution of the assets of the British corporation in the hands of the Tennessee court.

Since, however, a corporation is a "person" within the meaning of the fourteenth amendment (*Santa Clara County v. Southern Pacific Railroad Co.*, 118 U. S. 394, 396; *Smyth v. Ames*, 169 U. S. 466, 522), may not the Virginia corporation invoke for its protection the clause of the amendment declaring that no state shall deprive any person of property without due process, nor deny to any person within its jurisdiction the equal protection of the laws?

We are of opinion that this question must receive a negative answer. Although this court has adjudged that the prohibitions of the fourteenth amendment refer to all the instrumentalities of the state, to its legislative, executive and judicial authorities (*Ex parte Virginia*, 100 U. S. 339, 346, 347; *Yick Wo v. Hopkins*, 118 U. S. 356, 373; *Scott v. McNeal*, 154 U. S. 34, 45, and *Chicago, Burlington, etc., Railroad v. Chicago*, 166 U. S. 226, 233), it does not follow that, within the meaning of that amendment, the judgment below deprived the Virginia corporation of property without due process of law, simply because its claim was subordinated to the claims of the Tennessee creditors. That corporation was not, in any legal sense, deprived of its claim, nor was its right to reach the assets of the British corporation in other states or countries disputed. It was only denied the right to participate upon terms of equality with Tennessee creditors in the distribution of particular assets of another corporation doing business in that state. It had notice of the proceedings in the state court, became a party to those proceedings, and the rights asserted by it were adjudicated. If the Virginia corporation can not invoke the protection of

the second section of article 4 of the constitution of the United States relating to the privileges and immunities of citizens in the several states, as its coplaintiffs in error have done, it is because it is not a citizen within the meaning of that section; and if the state court erred in its decree in reference to that corporation, the latter can not be said to have been thereby *deprived* of its property without due process of law within the meaning of the constitution.

It is equally clear that the Virginia corporation can not rely upon the clause declaring that no state shall "deny to any person within its jurisdiction the equal protection of the laws." That prohibition manifestly relates only to the denial by the state of equal protection to persons "within its jurisdiction." Observe that the prohibition against the deprivation of property without due process of law is not qualified by the words "within its jurisdiction," while those words are found in the succeeding clause relating to the equal protection of the laws. The court can not assume that those words were inserted without any object, nor is it at liberty to eliminate them from the constitution and to interpret the clause in question as if they were not to be found in that instrument. Without attempting to state what is the full import of the words, "within its jurisdiction," it is safe to say that a corporation not created by Tennessee, nor doing business there under conditions that subjected it to process issuing from the courts of Tennessee at the instance of suitors, is not, under the above clause of the fourteenth amendment, within the jurisdiction of that state. Certainly when the statute in question was enacted the Virginia corporation was not within the jurisdiction of Tennessee. So far as the record discloses, its claim against the Embreeville company was on account of coke sold and shipped from Virginia to the latter corporation at its place of business in Tennessee. It does not appear to have been doing business in Tennessee under the statute here involved, or under any statute that would bring it directly under the jurisdiction of the courts of Tennessee by service of process on its officers or agents. Nor do we think it came within the jurisdiction of Tennessee, within the meaning of the amendment, simply by presenting its claim in the state court and thereby becoming a party to this cause. Under any other interpretation the fourteenth amendment would be given a scope not contemplated by its framers or by the people, nor justified by its language. We adjudge that the statute, so far as it subordinates the claims of private business corporations, not within the jurisdiction of the state of Tennessee (although such private corporations may be creditors of a corporation doing business in the state, under the authority of that statute), to the claims against the latter corporation of creditors residing in Tennessee, is not a denial of the "equal protection of the laws" secured by the fourteenth amendment to persons within the jurisdiction of the state, however unjust such a regulation may be deemed. \* \* \*

*Reversed as to the Ohio creditors; affirmed as to the Virginia coal corporation.*

Mr. Justice Brewer and Mr. Chief Justice Fuller dissenting.



*Note.* See, 1899, *Ward v. Connecticut P. M. Co.*, 71 Conn. 345, 42 L. R. A. 706, 71 Am. St. Rep. 207; 1899, *Hammond Beef Co. v. Best*, 91 Maine 431; 1899, *McClung v. Embreeville F., L. I. & R. Co.*, 103 Tenn. 399, 52 S. W. Rep. 1001. See following cases.

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Sec. 734. Same.

BLAKE v. McCLUNG.<sup>1</sup>

1900. IN THE SUPREME COURT OF THE UNITED STATES. 176  
U. S. Rep. 59-68.

[After decision of this court reported in 172 U. S. 239, *supra*, p. 2036, the Ohio creditors, Blake et al., asked for a decree in conformity thereto. The court rendered a decree which it is here claimed is not in accordance with that decree, and for which error is brought again.]

MR. JUSTICE HARLAN. \* \* \* (After quoting extensively from the former decision proceeds:) The state court adjudged:

"1. That the effect and purpose of the opinion and mandate of the supreme court of the United States in respect to the rights of C. G. Blake and Rogers, Brown & Co. is to adjudge and decree that the said C. G. Blake and Rogers, Brown & Co. are entitled to participate in the assets of the said Embreeville Freehold, Land, Iron and Railway Company, Limited, upon the basis of a broad distribution of the assets of said corporation among all of its creditors, without preference or priority, as though the act of 1877, chapter 31, had not been passed, and it is ordered that there be made a computation of the aggregate indebtedness due from the said insolvent corporation to its creditors of every class, wherever residing, and that there shall be paid to the said C. G. Blake and the said Rogers, Brown & Co. the percentage and proportion which is found to be due to them as creditors of said corporation in the aggregate of assets thus ascertained. 2. It is further adjudged and decreed, that after thus setting apart to the said C. G. Blake and Rogers, Brown & Co. the proportion and percentage thus found to be due to them, that all the rest and residue of the estate of the said Embreeville Freehold; Land, Iron and Railway Company, Limited, is applicable *first* to the payment of the indebtedness due to the creditors of said corporation *residing within the state of Tennessee*, as provided in section 5 of chapter 31 of the acts of Tennessee, 1877, and that the residue of said estate, if any, shall then be applied *pro rata* to the payment of the debts of the alien and non-resident creditors of said corporation, other than the said C. G. Blake and Rogers, Brown & Co." The cause was remanded to the court of original jurisdiction for the collection and distribution of the fund then in that court, and for the making of such further orders as might be found necessary to the final settlement of the cause. Mr. Justice Beard dissented upon grounds stated in his opinion, which is published in 52 S. W. Rep. 1001.

<sup>1</sup> That part of opinion quoted from former decision is omitted.



Blake and Rogers, Brown & Co. excepted to the action of the state court "in determining that creditors residing in Tennessee were entitled, under the act of 1877, chapter 31, section 5, to any priority or preference, by way of increased percentages in distribution" over them, on the ground that such priority and preference was in violation of section 2 of article 4 of the constitution of the United States, and was not consistent with the opinion and mandate of this court. The present writ of error was brought to review the last judgment.

We are constrained to hold that the judgment of the supreme court of Tennessee is not in conformity with the opinion and mandate of this court. The thought expressed in our former opinion was that Blake and Rogers, Brown & Co., citizens of Ohio and general creditors of the Embreeville Freehold, Land, Iron and Railway Company, were entitled, in the distribution in Tennessee of the assets of that insolvent corporation, to stand upon the same plane with citizens of Tennessee who were also general creditors of the same corporation; and that the judgment of the state court heretofore under review, 172 U. S. 239, so far as it gave priority to citizens of Tennessee over citizens of other states, was inconsistent with the second section of the fourth article of the constitution of the United States, providing that "the citizens of each state shall be entitled to all privileges and immunities of citizens in the several states."

By the judgment now under review certain creditors, solely because of their being citizens of Tennessee, are accorded advantages in the distribution of the assets in question which are denied to other creditors solely because of their being citizens of another state than Tennessee. That judgment gives to the plaintiffs in error, respectively, their percentage of the entire assets of the insolvent corporation upon the basis of equality among *all* the creditors, *wherever residing*, and that being done, the court in effect directs the idea of equality among all creditors to be abandoned, and "all the rest and residue of the estate" of the insolvent corporation to be applied *first* to the payment of the debts due to citizens of Tennessee. Thus the decree gave a decided advantage to Tennessee creditors over Ohio creditors, when, as Mr. Justice Beard correctly said, the cause was remanded by this court substantially with direction that the state court should see to it that no advantage accrued to Tennessee creditors over the Ohio creditors. \* \* \*

*Reversed.*

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Sec. 735. Same.

SULLY v. AMERICAN NATIONAL BANK.<sup>1</sup>

1900. IN THE SUPREME COURT OF THE UNITED STATES. 178 U. S. Rep. 289-304.

[This case involves the priority of creditors under the Tennessee statute involved in Blake v. McClung, *supra*, pp. 2036, 2045; a bill was filed in the Tennessee courts by the American National Bank, a Ten-

<sup>1</sup> Statement much abridged. Only the part of the opinion relating to the single point given.

nessee creditor, against a Virginia land company doing business in Tennessee, alleging the insolvency of the company, and the making of an assignment for the benefit of its creditors, without providing for the preference allowed by the Tennessee statutes, and asked for a receiver, marshaling of assets, and distribution of same according to the Tennessee statute. While this suit was pending, Sully and Carhart, residents of New York, filed a bill against the land company, and the Travelers' Ins. Co. of Connecticut, and the Connecticut Trust and Safety Deposit Co., alleging that Sully was the mortgagee in trust for Carhart, the sole holder of \$85,000 of bonds issued by the land company in 1893, secured by a mortgage, the same being duly registered in Tennessee July 10, 1893, and covering substantially all the property involved in the suit by the bank, and upon which the insurance and deposit company claimed a lien, and asking that the bill might be taken as a general creditor's bill, or a cross-bill in the bank suit. The Travelers' Insurance Company also filed a bill setting forth its claim of \$30,000, secured by mortgage, of which the deposit company was trustee, upon part of the property involved in the bank, and the Sully cases, and asked to have its claim declared a preferred claim, alleging it was prior to the Carhart claim. The bank filed an answer denying the validity of the Carhart claim, and alleged that if it was found to be valid, the bank was entitled to preference in payment. The suits were finally consolidated and a decree was rendered, finding Carhart to be the *bona fide* holder of the bonds, and that he was entitled to recover on the same, but subject to the payment of the Tennessee creditors upon debts existing prior to the registration of the mortgage; the same was found as to the insurance company. This decree was affirmed by the appeal court, and finally by the supreme court of Tennessee, from which the case is brought here on writ of error by Carhart and the insurance company, and some of the unsecured creditors.]

MR. JUSTICE PECKHAM. \* \* \* Part of the fifth section of the act of 1877 provides: "Nevertheless, creditors who may be residents of this state shall have a priority in the distribution of assets, or subjection of the same, or any part thereof, to the payment of debts over all simple contract creditors, being residents of any other country or countries, and also over mortgage or judgment creditors, for all debts, engagements and contracts which were made or owing by said corporation previous to the filing and registration of such valid mortgages, or the rendition of such valid judgments."

Under this provision of the section, creditors of the land company residing in Tennessee, whose debts accrued prior to the filing and registration of the Sully, trustee, mortgage were by the decree of the court below preferred in payment over the mortgagee. By reason of such preference Carhart did not receive what he would have received but for the preference so given. He claims that this preference in favor of resident creditors, whose debts existed when his mortgage was registered, is an illegal discrimination against him as a non-resident mortgagee, because the statute, as he says, while directing

such a discrimination against a non-resident mortgagee, does not permit it as against a resident mortgagee. Such a discrimination, if it existed, is invalid within the decision of *Blake v. McClung, supra*.<sup>1</sup>

It is objected, however, on the part of the defendants in error, that this is a merely abstract or moot question, because there are no resident mortgagees, and their rights have not, therefore, been determined. The objection is not well taken. Although there are no resident mortgagees in this case, yet the decree of the court below, following the statute, has postponed the payment of the mortgage, in favor of resident creditors whose debts accrued prior to the registration of that mortgage. If the statute does not permit such postponement against a resident mortgagee, then the postponement in the case of a non-resident mortgagee would be invalid. The postponement has in fact been made as against the non-resident mortgagee, and whether that postponement was legal and valid is no mere abstraction, because by reason thereof this non-resident mortgagee has actually suffered a loss in the payment of his mortgage. It is therefore entirely immaterial whether, in this particular case, there are or are not resident mortgagees. We are in this case necessarily brought to a decision of the question, whether the postponement was valid, and that depends upon the question, whether the act permits a similar postponement in the case of a resident mortgagee? If it does, it is conceded that the act is valid, so far as this particular question is concerned.

For us to hold that such postponement is not permitted in the case of a resident mortgagee is to condemn the statute on that point as a violation of the constitution of the United States. Such a construction should not be adopted if the statute is reasonably susceptible of another which renders it valid. That rule applies, even though on some other point the statute has been already held to be a violation of the federal constitution.

We think the true construction of the statute requires us to hold that the resident owner of a mortgage would be postponed in its payment in favor of those debts made or owing by the corporation prior to the filing and registration of his mortgage. In other words, that the Tennessee general creditor has the same right of preference as against a resident mortgagee that he has against a non-resident, and the same burden that is placed upon non-resident mortgagees and judgment creditors is by the statute placed upon resident mortgagees and judgment creditors. We do not think that this construction leads to any absurd result.

It is urged that if it were to be so construed, a Tennessee creditor who had no mortgage or judgment would share with all other unsecured Tennessee creditors in the assets of the insolvent company, but that if he, being such creditor, took a judgment or mortgage as a security for the payment of his debt, he would thereby lose his right to share with the other resident non-secured creditors, and the latter would have a preferred right of payment over him for all debts of the company existing at the time of the registration of the mortgage. The creditor, it is said, would thus lose his right as a general creditor,

<sup>1</sup> Page 2036.

and he would obtain no lien by his mortgage or judgment as against those creditors of whom he was one before he took his mortgage.

We agree that a construction which leads to such a result would be absurd, but such a result does not follow from our construction of the statute. When the Tennessee creditor takes his mortgage or recovers his judgment to secure an existing indebtedness, a new debt is not thereby created, but he has simply received, or obtained, a security for its payment, and a preference as against all other creditors whose debts may accrue subsequently to the filing and registration of his mortgage or the recovery of his judgment. He gains no priority over existing creditors of his class by taking a mortgage or judgment. The debts existing at that time, including his own, are to be paid, and it is only against debts subsequently incurred that the mortgage, or the judgment, has a preferential lien. If the debt for which he took the mortgage existed prior to the execution thereof, the mortgagee did not, by taking his mortgage, lose his right to share with the other unsecured creditors, but he did not acquire the right to assert the lien of his mortgage in preference to and against those creditors whose debts existed at the time of its registration. His rights as a general creditor of the land company, existing prior to the registration of the mortgage, were not in any manner lost or affected by the mortgage. He can not assert the lien of his mortgage against prior creditors, but he does not lose his own right as a prior creditor by taking the mortgage. Although the act was evidently passed for the purpose of awarding certain preferences to Tennessee over foreign creditors, yet we see nothing in its general purpose which requires us to consider the act as making a distinction in favor of a Tennessee mortgagee as against a non-resident mortgagee.

While the effect of this construction deprives both classes of mortgagees, in case of insolvency of the mortgagor, of any benefit from their mortgages as against resident non-secured creditors existing when the mortgages were registered, yet, at the same time, it permits such mortgagees to share in the distribution of assets with such unsecured creditors, provided their own debts existed prior to the taking of the mortgage, and did not spring into existence simultaneously with the mortgage.

The rights of Carhart as a secured creditor must be adjusted with reference to these views. If his secured debt, or any portion thereof, did in fact exist prior to his mortgage, he is entitled to share with other unsecured creditors who are residents of the state of Tennessee.

\* \* \*

*Affirmed as to the non-resident secured creditors. Reversed upon another point as to unsecured non-resident creditors.*

*Note.* See 1900, *MacMurray v. Sidwell*, 155 Ind. 560, 80 Am. St. R. 255, 58 N. E. 722; 1900, *Dearing v. McKinnon Dash, etc., Co.*, 165 N. Y. 78, 80 Am. St. R. 708, 58 N. E. 773.

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<sup>1</sup> Page 2036.



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**Sec. 736. Same. (b)** Power to subject corporate assets within the state to the payment of home creditors.

THE PEOPLE OF THE STATE OF NEW YORK, RESPONDENT, v. THE  
GRANITE STATE PROVIDENT ASSOCIATION AND D. A.  
TAGGART, ASSIGNEE.<sup>1</sup>

1900. IN THE COURT OF APPEALS OF NEW YORK. 161 N. Y.  
492-499.

O'BRIEN, J. The only question in this case is one concerning the distribution of a fund now under the control of the courts of this state, which is owned by a foreign corporation. The defendant corporation was created by the laws of New Hampshire as a building and loan association, and was permitted to transact business in this state. In January, 1896, the authorities of the state where this corporation is domiciled took proceedings in the courts of that state to restrain it from any further prosecution of its business. In this proceeding an assignee or trustee was appointed to take charge of the property, as provided by the local law. Subsequently this action was brought in the courts of this state by the attorney-general, in behalf of the people, under the provisions of the code, for the sequestration and preservation of the assets and property of the corporation in this state, and for an equitable distribution of the same among the persons entitled thereto. In order to carry out the objects of the action a receiver was also appointed in this state. The New Hampshire assignee upon his own application was made a party to the action, and so is bound by the judgment.

It appears from the record that the corporation transacted business in several other states. The stockholders at the time of the appointment of the receiver in this state exceeded in number twenty thousand, of whom nearly one-sixth were residents of this state, and about one-fourth of the assets was located here; or, at least, the situation was such that they could not be collected or distributed except through the action of the courts of this state. The fund in controversy may be divided into two parts. About \$69,000 represents assets of the corporation collected by the receiver in this action from the foreclosure of mortgages and other obligations due from parties in this state, and the sale of some realty located in this state. The securities thus collected were transmitted to the receiver by the assignee in New Hampshire under the direction of the courts of that state. The other part of the fund consists of a special deposit of \$100,000, which the corporation was required to make under the banking law of this state in order to acquire the right to transact its business here.

With respect to the part of the fund first mentioned, which is described in the record as the general fund, the court below, by the amendment of the original judgment, directed the receiver in this state, after paying the expenses of the receivership, to transmit the

<sup>1</sup> Statement, except as given in the opinion, arguments, and dissenting opinion of Parker, Ch. J., omitted.

same to the assignee in New Hampshire for general administration, upon receiving from such assignee at the domicile a bond or undertaking in a sum equal to double the amount to be so paid over, with sufficient sureties to be approved by a justice of the court, conditioned for the payment by the assignee of the domicile to each creditor and shareholder resident in this state of the same dividend on his claim that may be awarded other creditors and shareholders throughout the country, without any deduction on account of any sum the creditor and shareholder of this state might receive from the special fund hereafter mentioned; and that in default of such payment to the domestic creditors and shareholders, that the foreign assignee would return to the receiver in this state, or his successor, the general fund so paid over. The only objection made to this part of the judgment is to the provision which requires the assignee at the domicile to execute the bond before described as a condition of receiving the fund in the hands of the domestic receiver. The general assets of a corporation are to be administered and distributed at the home of the corporation; but in order to accomplish that result, ancillary trustees or assignees must frequently be appointed in other jurisdictions, subject to the control and direction of the local courts. All creditors of a corporation, wherever residing, are entitled, in case of insolvency, to have the general assets distributed among them upon principles of perfect equality.

The courts of one state have no right to favor domestic creditors in the distribution, but it must be made upon the principle that equality is equity. (*Blake v. McClung*, 172 U. S. 239.)

In the case at bar the foreign assignee is a party to the action upon his own application; he asks for the transmission to him in another state of the fund now under the control and in the custody of the courts of this state through the receiver. We think that the court below, in directing the transmission of the fund to another jurisdiction, had the power to impose such conditions as are just and reasonable, with a view to the protection of domestic creditors, and that was the only purpose for which the bond or undertaking was required. We do not think it can be said, as matter of law, that the court was bound to direct the transmission of the fund to the administration at the domicile without exacting any conditions whatever. It doubtless had the power to do so if it was thought to be wise and expedient. But it determined that before sending the fund out of the jurisdiction of the court, it was just and reasonable to require the foreign assignee to give security to the effect that he would distribute the fund upon principles of perfect equality. In other words, the court had power to guard against any discrimination on the part of the foreign assignee against domestic creditors by reason of any trust fund which was held in this state for their benefit. (*People v. Remington*, 121 N. Y. 328.) We think, therefore, that no rule of law or any absolute legal right of the foreign assignee was violated by that provision of the judgment requiring him to give the security referred to.

The fund in the hands of the domestic receiver, arising from the

conversion of the special deposit in the banking department, stands upon a different ground. The defendant, in order to acquire the right to transact its business in this state, was obliged to make this deposit since the statute so provides. If this was a deposit as security merely for domestic creditors, we would be inclined to agree with the learned counsel for the defendant, who insists that this fund should be devoted to the benefit of all creditors equally wherever residing. But it is something more than a mere deposit as security. It is in the nature of a fund held in trust for the benefit of domestic creditors and shareholders of the defendant. The deposit was made in obedience to section fourteen of the banking law, as a condition of the defendant's right to transact business here. By section thirty-three it is provided, in substance, that upon the appointment of the receiver of a corporation in this state, the superintendent of the banking department shall pay over to him the funds remaining in his hands, less any charges that he may have against the same, and the receiver shall distribute these funds among the creditors and shareholders of the corporation residing in this state, in the manner prescribed by law for the payment of creditors in the case of voluntary dissolution of a corporation. It is apparent from the provisions of these two sections, that the securities so deposited were held by the superintendent as a trustee for domestic creditors and shareholders. The defendant corporation in making the deposit must be deemed to have consented that in case of insolvency the fund might be distributed according to the terms of the statute; that is to say, to creditors and shareholders residing in this state. So that by the act of the corporation itself, in availing itself of the benefit of the statute, it has devoted this fund to the benefit of the domestic creditors and shareholders; at least so far as to enable them to receive payment upon all their obligations in full. Therefore, the application of the fund to their benefit in the first instance does not infringe upon the provision of the federal constitution, that citizens of each state shall be entitled to all the privileges and immunities of citizens in the several states. (*Blake v. McClung, supra.*)

The court below, therefore, directed that this fund be disposed of in the following manner, after paying the expenses of administration:

(1) In case the foreign assignee should give the undertaking provided for, with respect to the general fund, and the whole fund received by him was insufficient to pay all the creditors throughout the country in full, then the domestic receiver should pay from this special fund the balance of all just claims due to the creditors residing within this state at the time of his appointment, and after such payment distribute the balance of the special fund remaining in his hands among the different shareholders residing within this state until they were paid in full.

(2) In case the fund in the hands of the foreign assignee should prove to be sufficient to pay all the creditors in full, but insufficient to pay the shareholders throughout the country in full, then the domestic receiver should distribute the balance remaining in his hands to the

domestic shareholders at the time of his appointment until they were paid in full.

(3) That in case anything remained in his hands after paying the claims of the creditors and shareholders in this state in full and all expenses, the same should be paid to the assignee at the place of the domicile.

Assuming that the special deposit referred to was a fund held in trust here for the benefit of domestic creditors and shareholders, as we think it was, there is no legal error in this principle of distribution. It is quite true, as the counsel for the defendant suggests, that it impounds a large sum, a part of the assets of the corporation, for the benefit of creditors here. But we think the answer to all that is, that there is no injustice in devoting the fund to the very purpose for which it was created and sent here. The corporation could have declined to enter the state upon such conditions, but having accepted them by making the deposit, no creditor or shareholder in any other state can complain because the courts of this state have, with the consent of the corporation, devoted the fund in the first instance to the payment of home creditors and shareholders. The defendant virtually consented, when it made the deposit, that it should be distributed in this manner in case of insolvency.

The judgment appealed from should, therefore, be affirmed, with costs to the foreign and domestic receivers, respectively, to be paid out of the general fund.

*Note.* See, 1887, *Strangham v. Hallwood*, 30 W. Va. 274, 8 Am. St. Rep. 29, note, p. 49; 1889, *Humphreys v. Hopkins*, 81 Cal. 551, 15 Am. St. Rep. 76; 1894, *Holbrook v. Ford*, 153 Ill. 633, 46 Am. St. Rep. 917; 1897, *Grogan v. Egbert*, 44 W. Va. 75, 67 Am. St. Rep. 763. See, also, note, *supra*, p. 2049.

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**Sec. 737. Same. 6. Power of the court to provide for the payment of the claims of certain creditors in preference to prior liens.**

**MR. JUSTICE HARLAN IN SOUTHERN RAILWAY COMPANY v. CARNEGIE STEEL COMPANY.<sup>1</sup>**

1900. IN THE SUPREME COURT OF THE UNITED STATES. 176 U. S. 257-297.

[Writ of certiorari to review decree of the Circuit Court of Appeals, allowing certain claims of the steel company as preferential debts arising from the operation of railroads in the hands of receivers. June 15, 1892, Clyde and others, citizens of New York, for themselves and other creditors and stockholders of the Richmond and Danville R. R. Co., and other defendant corporations, brought suit in the United States Circuit Court, eastern district of Virginia, against the

<sup>1</sup> Statement much abridged. Much of the opinion and the short dissenting opinion of Mr. Justice White omitted.

Richmond and Danville R. R. Co. (called here the Danville Company) and the Richmond & W. P. Terminal Ry. & W. Co. (called the Terminal Company), Virginia corporations, setting forth that the Danville Company owned 164 miles of railroad, with a capital stock of \$5,000,000 (a large majority being owned by the Terminal Company), and by lease, ownership of stock or operating contracts had possession, and operated and controlled more than 3,100 miles of railway in six states, and also one steamboat company—the aggregate outstanding stock of all controlled companies being over \$43,000,000, about \$11,000,000 being owned by other than the defendant companies; the bonded debts and rental obligations assumed by the Danville Company for its allied lines amounted to over \$71,000,000, embraced in fifty-nine different classes, issued by the several companies, secured by separate mortgages or deeds of trust, while its own bonded debt was over \$16,000,000 in five different issues of securities, all of the sixty-four issues being capable of separate default or foreclosure. That in addition to this the Danville Company had outstanding car trust obligations to amount of \$1,500,000, and a floating debt of over \$5,000,000, and also an *emergency* loan of \$600,000, partly advanced by the plaintiffs to prevent default in April, 1892. It was also alleged that the Terminal Company, through its control by stock ownership of the Danville Company, had compelled it jointly with the East Tennessee, Virginia and Georgia Railway Company to issue \$6,000,000 of bonds, guaranteed by the Terminal Company, secured by the pledge of stock of the Alabama and Great Southern Railway (of uncertain value, because subject to a prior heavy mortgage), this road being a central link in the eastern Tennessee system of over 2,300 miles of road; also the Terminal Company compelled the Danville Company to become assignee and guarantor of a lease of all the system of railroad and steamship lines owned and controlled by Central Railroad Company, of Georgia, for a long period of years, to the Georgia Pacific Railway Company, and bind itself to operate it, pay interest on its bonded debt and all rental obligations, and execute a bond of \$1,000,000 for the faithful performance of these covenants. The bill further set forth that the owners of all these claims were far separated and numerous; that default in payment of interest and many other claims was imminent, and if it occurred the whole system of railroads would be dismembered in a scramble for priority, and in the conflicting jurisdiction of courts where suits would be brought; that it was for the best interest for all that the system be not disrupted; that if it was, a depreciation of many million dollars would result, and that the corporations were in fact insolvent, and asked that plaintiffs be declared to have a specific lien under the *emergency* loan, upon all the income of the Danville Company and its allied lines, that the court would marshal all the assets and ascertain all liens and priorities, and administer as a trust fund all the assets and property of both defendant corporations, and appoint one or more receivers for that purpose. Upon hearing, June 16, the court appointed two receivers (called in-



solvency receivers) clothing them with full *power to operate the property, and pay all expenses thereof, and also to pay all such prior traffic, mileage and damage claims, as they should think proper to be paid as operating expenses, and all supply and labor claims incurred in the operation of the system at any time within six months prior thereto.* Upon that and succeeding days auxiliary suits were instituted by same plaintiffs against the Danville Company in United States Circuit and District Courts, in other states where the Danville Company operated roads, and orders were obtained confirming the appointment of the receivers, and recognizing the Circuit Court of the Eastern District of Virginia as having primary jurisdiction over all the system and property of the Danville Company; June 28 same plaintiffs filed another petition making the Central Trust Company of New York, trustee for the five issues of the mortgage bonds of the Danville Company, defendants, so they might be heard, asking that the receivers might be allowed to issue \$1,000,000 receiver's certificates which should be a first lien upon the property of the Danville Company, its leasehold interests, contracts and income, for the purpose of using the proceeds to pay for materials and supplies used in operating the roads in the receivers' hands, and which were purchased six months prior to June 15, 1892. The trust company was represented at the hearing and made no objection, and the court ordered the issue of \$1,000,000 receiver's certificates. July 13, 1892, the trust company, upon its application for the purpose of protecting the bondholders of the Danville Company, and representing many other mortgages and railroads, was allowed to intervene, "on condition that it hereby submits to the several orders heretofore entered herein." It asked that the same receivers be appointed as permanent receivers, and an order to that effect was made. December 19, other parties representing underlying bonds of various parts of the system were allowed to intervene. In the Clyde suit the Carnegie Steel Company filed with the master, October 14, 1892, claims for furnishing 4,203 tons of steel rail, at \$125,067, at various times upon contracts entered into between June 10 and October 10, 1891, for which notes had been taken, and which had been renewed for three and four months at the time the Clyde suit was begun, and were due between June 21 and October 10, 1892. April 13, 1894, the Central Trust Co. filed a separate suit against the Danville Company to foreclose the consolidated gold mortgage of about \$4,500,000; and upon motion of the trust company the two former receivers with a third were appointed receivers of all the property involved in the Clyde suit with its interveners, all of whom were made defendants, the order stating that nothing in this order should vacate any former order in the Clyde suit, and the court reserving the right to determine all questions of creditors claiming any preference to the mortgage upon either the property or income. The Carnegie Company was permitted to intervene in this foreclosure suit, setting forth its claim as before, and alleging it was entitled to priority over the mortgage debt. All the suits were finally consolidated, and the Carnegie Company, upon its application, was made a defendant in the con-



solidated suit. A decree of foreclosure was issued in the consolidated suit, and the sale took place June 15, 1894, all the property being sold as a unit, and purchased by a committee on behalf of and for the sole use of the Southern Railway Co. of Virginia, then organized to take over the property. The decree of confirmation reserved the right to require the Southern Company to pay all "such sums as have been or may be ordered by the court for the payment of any and all receivers' debts or claims adjudged or to be adjudged as prior in lien or equity to the mortgage herein foreclosed, or entitled to preference in payment of the proceeds of sale, "under penalty of retaking possession of the property and reselling it upon failure to comply with the order of the court, or to pay any and all such debts, liens, or claims as it may decree ought to be paid out of the proceeds of sale in preference to the mortgage herein foreclosed." The court, upon report of the master, found the Carnegie claim to be correct, and with interest to amount to \$154,895, and that "the earnings which should have been used for the payment of current expenses, including this claim, had been used for the benefit of mortgage creditors in a sum more than sufficient to pay this claim," and it was therefore entitled to priority of payment out of the funds resulting from the sale of the property, over the mortgage foreclosed, and it was ordered that the Southern Railway Co. forthwith pay this sum. The Southern Railway Co. presented an appeal from his order to the Circuit Court of Appeals, which affirmed the decision below. 76 Fed. Rep. 492.]

The respective rights of the mortgagees of a railroad company and of parties having claims against it at the time its property passed into the hands of receivers have been frequently the subject of consideration by this court. But as counsel differ as to the scope and effect of former decisions, it is necessary to examine them and ascertain whether those decisions embrace the case now before the court.

The leading case is *Fosdick v. Schall*, 99 U. S. 235, 252, 253, which related to a claim against a railroad company for rent of cars. In that case Chief Justice Waite delivered the unanimous judgment of the court. After observing that the business of all railroad companies was done to a greater or less extent on credit, and that this credit was longer or shorter as the necessities of the case required, said: "The income out of which the mortgagee is to be paid is the net income obtained by deducting from the gross earnings what is required for necessary operating and managing expenses, proper equipment and useful improvements. Every railroad mortgagee in accepting his security impliedly agrees that the current debts made in the ordinary course of business shall be paid from the current receipts before he has any claim upon the income. If, for the convenience of the moment, something is taken from what may not improperly be called the current debt fund, and put into that which belongs to the mortgage creditors, it certainly is not inequitable for the court, when asked by the mortgagees to take possession of the future income and hold it for their benefit, to require as a condition of such an order that what is due from the earnings to the current debt shall be paid by the

court from the future current receipts before anything derived from that source goes to the mortgagees. In this way the court will only do what, if a receiver should not be appointed, the company ought itself to do. For even though the mortgage may in terms give a lien upon the profits and income, until possession of the mortgaged premises is actually taken or something equivalent done, the whole earnings belong to the company and are subject to its control." The court further said: "The mortgagee has his strict rights, which he may enforce in the ordinary way. If he asks no favors he need grant none. But if he calls upon a court of chancery to put forth its extraordinary powers and grant him purely equitable relief, he may with propriety be required to submit to the operation of a rule which applies in such cases, and do equity in order to get equity. The appointment of a receiver is not a matter of strict right. Such an application calls for the exercise of judicial discretion, and the chancellor should so mold his order that, while favoring one, injustice is not done to another. If this can not be accomplished the application should ordinarily be denied. We think, also, that if no such order is made when the receiver is appointed, and it appears in the progress of the cause that bonded interest has been paid, additional equipment provided, or lasting and valuable improvements made out of earnings which ought in equity to have been employed to keep down debts for labor, supplies and the like, it is within the power of the court to use the income from the receivership to discharge obligations which, but for the diversion of funds, would have been paid in the ordinary course of business. This, not because the creditors to whom such debts are due, have in law a lien upon the mortgaged property or the income, but because in a sense the officers of the company are trustees of the earnings for the benefit of the different classes of creditors and stockholders; and if they give to one class of creditors that which properly belongs to another, the court may, upon an adjustment of the accounts, so use the income which comes into its own hands as, if practicable, to restore the parties to their original equitable rights. While, ordinarily, this power is confined to the appropriation of the income of the receivership, and the proceeds of moneyed assets that have been taken from the company, cases may arise where equity will require the use of the proceeds of the sale of the mortgaged property in the same way. \* \* \*

No fixed and inflexible rule can be laid down for the government of the courts in all cases. Each case will necessarily have its own peculiarities, which must to a greater or less extent influence the chancellor when he comes to act. The power rests upon the fact that in the administration of the affairs of the company the mortgage creditors have got possession of that which in equity belonged to the whole or a part of the general creditors. Whatever is done, therefore, must be with a view to a restoration by the mortgage creditors of that which they have thus inequitably obtained. It follows that if there has been in reality no diversion, there can be no restoration; and that the amount of the restoration should be made to depend upon the amount

of the diversion. If, in the exercise of this power, errors are committed, they, like others, are open to correction on appeal. All depends upon a proper application of well settled rules of equity jurisprudence to the facts of the case as established by the evidence." \* \* \*

(Citing, and quoting extensively to the same effect, from *Hale v. Frost*, 99 U. S. 389; *Burnham v. Bowen*, 111 U. S. 776, 780, 783; *Union Trust Co. v. Morrison*, 125 U. S. 591, 609, 612; *St. Louis, Alton, etc., R. R. Co. v. C. C., etc., Ry. Co.*, 125 U. S. 658, 673.)

In *Kneeland v. American Loan and Trust Co.*, 136 U. S. 89, 97. this court said: "The appointment of a receiver vests in the court no absolute control over the property, and no general authority to displace vested contract liens. Because in a few specified and limited cases this court has declared that unsecured claims were entitled to priority over mortgage debts, an idea seems to have obtained that a court appointing a receiver acquires power to give such preference to any general and unsecured claims. It has been assumed that a court appointing a receiver could rightfully burden the mortgaged property for the payment of any unsecured indebtedness. Indeed, we are advised that some courts have made the appointment of a receiver conditional upon the payment of all unsecured indebtedness in preference to the mortgaged liens sought to be enforced. Can anything be conceived which more thoroughly destroys the sacredness of contract obligations? One holding a mortgage debt upon a railroad has the same right to demand and expect of the court respect for his vested and contracted priority as a holder of a mortgage on a farm or lot. So, when a court appoints a receiver of railroad property, it has no right to make that receivership conditional on the payment of other than those few unsecured claims which, by the rulings of this court, have been declared to have an equitable priority. No one is bound to sell to a railroad company or to work for it, and whoever has dealings with a company when property is mortgaged must be assumed to have dealt with it on the faith of its personal responsibility, and not in expectation of subsequently displacing the priority of the mortgage liens. It is the exception, and not the rule, that such priority of liens can be displaced." Again: "It is the exception, and not the rule, that such priority of liens can be displaced. We emphasize this fact of the sacredness of contract liens, for the reason that there seems to be growing an idea that the chancellor, in the exercise of his equitable powers, has unlimited discretion in this matter of the displacement of vested liens." These principles were reaffirmed in *Thomas v. Western Car Co.*, 149 U. S. 95, 110, in which it was held that the car company there seeking a preference over mortgage creditors had contracted upon the responsibility of the railroad company, and not in reliance upon the interposition of a court of equity; consequently its claim to a preference was denied. \* \* \*

(Citing and quoting from *Virginia & Alabama Coal Co. v. Central, etc., R. Co.*, 170 U. S. 355, 365, 368.)

It is apparent from an examination of the above cases that the decision in each one depended upon its special facts. This court has

uniformly refrained from laying down any rule as absolutely controlling in every case involving the right of unsecured creditors of a corporation, whose property is in the hands of a receiver, to have their demands paid out of net earnings in preference to mortgage creditors. But it may be safely affirmed, upon the authority of former decisions, that a railroad mortgagee when accepting his security impliedly agrees that the current debts of a railroad company contracted in the ordinary course of its business shall be paid out of current receipts before he has any claim upon such income; that, within this rule, a debt not contracted upon the personal credit of the company, but to keep the railroad itself in condition to be used with reasonable safety for the transportation of persons and property, and with the expectation of the parties that it was to be met out of the current receipts of the company, may be treated as a current debt; that whether the debt was contracted upon the personal credit of the company, without any reference to its receipts, is to be determined in each case by the amount of the debt, the time and terms of payment, and all other circumstances attending the transaction; and that when current earnings are used for the benefit of mortgage creditors before current expenses are paid, the mortgage security is chargeable in equity with the restoration of any funds thus improperly diverted from their primary use. The doctrine announced in *Burnham v. Bowen*—in which case the decisions in prior cases were affirmed—is thus expressed in the recent case of *Virginia & Alabama Coal Co. v. Central Railroad Company*, above cited: “The dominant feature of the doctrine as applied in *Burnham v. Bowen*, is that, where expenditures have been made which were essentially necessary to enable the road to be operated as a continuing business, and it was the expectation of the creditors that the indebtedness created would be paid out of the current earnings of the company, a superior equity arises in favor of the material-man as against the mortgage bond in the income arising both before and after the appointment of a receiver from the operation of the property. The equity thus held to arise when a purchase of necessary current supplies is made by the owning company is not in anywise influenced by the fact that the company itself is the purchaser of the supplies, but is solely dependent upon the fact that the supplies are sold and purchased for use, and that they are used in the operation of the road, that they are essential for such operation, and that the sale was not made simply upon personal credit, but upon the tacit or express understanding that the current earnings would be appropriated for the payment of the debt.”

Can the decree below be sustained consistently with these principles? Are the debts due the Carnegie Company of the class designated in the adjudged cases as current debts contracted, not on the personal credit of the railroad company, but in the ordinary course of its business, and to be met out of current receipts? As already said, whether the parties, seller and buyer, had in view only the personal credit of the latter is to be determined in each case by its special facts, including the amount of the debt and the terms of payment. \* \* \*

(Reciting the facts as to the purchase of the rails, as heretofore, and in addition stating they were not all purchased at one time, but in small amounts, to be paid for on short time, and that 1,100 tons were used on the Northeastern Railroad in Georgia, 1,270 tons on the Virginia Midland, 1,793 tons on the Danville and 31 tons on the Georgia Pacific.)

What was the condition of the roads owned and controlled by the Danville Company at the time the rails were purchased and used? It was in the power of the railroad company and its receivers, who had possession of the books of the company, to have furnished evidence on this point that would have removed all possible doubt. But there is enough in the record to show that the rails purchased from the Carnegie Company were needed in order that the roads in question might be kept by the railroad company in that condition of safety which its duty to the public and to the mortgage bondholders required. In August, 1892, *immediately after the receiver took possession of the railroads constituting the Danville system*, they reported to the court that the financial difficulties of the Danville Company during the previous two years had "prevented the operating officers from being able to expend the proper amount *for new rails, and upon the road-bed and structures, to keep the railroad in the condition in which it should be maintained*, and it will be necessary for the receivers during the summer and autumn to make a much larger expenditure than they would for ordinary maintenance." Here is a direct admission by the receivers, that during the *two years* immediately preceding their appointment, the railroad company had not expended for new rails and upon the road-bed and structures the amount necessary to keep its road in proper condition. There is no evidence in the record which even tends to show that the statements of the receivers on this point were not strictly accurate. But this purchase of new rails proved to be inadequate, for on the 27th of January, 1894, the foreclosure receivers represented to the court by petition that "*for the proper and economical operation of the lines of railroad of which they are receivers, and for the safety of passengers and property transported over such roads*, as required by the order of this court appointing such receivers, two thousand tons of new steel rails are *an absolute necessity*," and that they had "negotiated with and purchased from the Carnegie Steel Company, Limited, subject to the approval of the court, that quantity of rails at the cost of \$24 per ton." The court made an order in accordance with that petition. Again, on the 13th day of April, 1894, the court—all parties to the foreclosure suit consenting thereto, including the bondholders' committee—made an order authorizing the receivers to purchase 2,500 tons of new steel rails, in order "*to properly operate the railroads*" in their charge, "*and for the safety of persons and property transported.*"

It is apparent that the purchases of new steel rails while the railroads were in possession of receivers were made in the ordinary course of business and were properly chargeable upon and payable out of current receipts in preference to the claims of mortgage cred-



itors. In every substantial sense the expenses thus incurred were operating expenses. They were incurred in the interest of mortgage creditors, the value of whose securities depended upon the unity of the Danville system being preserved and the interests of all concerned not allowed to go to ruin. Why should a different rule be applied to the contracts made with the Carnegie Company *shortly before the appointment of receivers in the Clyde suit*, the original contract being for only 2,500 tons, and the last one for only 1,656 tons? Is it to be said that the contract for 2,000 tons of steel rails and the contract for 2,500 tons made by the receivers in the foreclosure suit created debts of a preferential character, while contracts made by the railroad company of exactly the same kind shortly before the appointment of receivers for 2,500 and 1,656 tons of steel rails could not, under any circumstances, become a preferential debt chargeable upon current receipts? Surely the quantity of rails purchased from the Carnegie Company and delivered in 1891 was insignificant in view of the interests involved and the extensive mileage of the Danville system, and was by no means so large as to suggest that they were to be used in constructing new and additional road, and not to keep existing roads in proper condition for use. Every railroad company must have on hand a limited quantity of rails in order to keep every part of its line in proper and safe condition. It is evident that the Carnegie rails purchased shortly before the receivers in the Clyde suit were appointed—the rails here in question—were obtained for the same reason that induced the subsequent purchases by the receivers. \* \* \*

We next inquire whether it was not at the time the expectation of both parties, vendor and vendee, that the rails delivered by the Carnegie Company between July 25, 1891, and October 10, 1891, should be paid for out of the current earnings of the railroad company? The attendant circumstances require an affirmative answer to this question, although the parties did not in express words declare that the debts due contracted with the Carnegie Company were to be charged upon the current earnings of the railroad company. The quantity of rails was not so large as to preclude the expectation that they could be paid for out of the current earnings of the railroad company. As already said, it was a very small quantity for purposes of ordinary or necessary repairs, and there is nothing in the record to show that the Carnegie Company relied merely or exclusively on the personal credit of the railroad company. The renewal notes executed by the railroad company were *all* within the *three months immediately preceding the appointment of the receivers*. \* \* \*

(The learned justice further held that the fact that the rails were largely used upon the allied lines of the system inured to the benefit of the bondholders, and after consideration of the financial management in detail also concluded that during both the insolvency and foreclosure receiverships “immense sums were expended in paying interest, sinking-fund and car trust debts, and for construction and equipment, which were all for the benefit of mortgage creditors, and which to the



extent necessary should have been applied in payment of preferential claims, including those of the Carnegie Company.'')

We must not be understood as saying that a general unsecured creditor of an insolvent railroad corporation in the hands of a receiver is entitled to priority over mortgage creditors in the distribution of net earnings simply because that which he furnished to the company prior to the appointment of the receiver was for the preservation of the property and for the benefit of the mortgage securities. That, no doubt, is an important element in the matter. Before, however, such a creditor is accorded a preference over mortgage creditors in the distribution of net earnings in the hands of a receiver of a railroad company, it should reasonably appear from all the circumstances, including the amount involved and the terms of payment, that the debt was one fairly to be regarded as part of the operating expenses of the railroad incurred in ordinary course of business, and to be met out of current receipts. \* \* \*

*Affirmed.*

*Note.* See, 1878, *Fosdick v. Schall*, 99 U. S. 235; 1885, *Union Trust Co. v. Ill. Mid. Ry. Co.*, 117 U. S. 434; 1892, *Farmers' L. & T. Co. v. Kansas City, etc., Co.*, 53 Fed. Rep. 182; 1895, *Farmers' L. & T. Co. v. N. Pac. R.*, 68 Fed. Rep. 36; 1898, *Louisville Trust Co. v. Louisville, etc., Ry. Co.*, 174 U. S. 674; 1898, *Knickerbocker v. McKindley Coal Co.*, 172 Ill. 535, 64 Am. St. Rep. 54; 1899, *Lackawanna Co. v. Farmers' L. & T. Co.*, 176 U. S. 298; 1899, *Hale v. Hardon*, 95 Fed. Rep. 747; 1900, *International Trust Co. v. U. C. Co.*, 27 Colo. 246, 60 Pac. Rep. 621; 1900, *Standley v. Hendrie & B. Mfg. Co.*, 27 Colo. 331, 61 Pac. Rep. 600. *Note*, 83 Am. St. R. 72.

## ARTICLE II. CONTRIBUTION AS TO EXPENSE OF ENFORCING REMEDIES.

### Sec. 738.

#### HELM v. SMITH-FEE CO.

1900. IN THE SUPREME COURT OF MINNESOTA. 79 Minn. Rep. 297, 82 N. W. Rep. 639.

[Action to enforce liability of stockholders to creditors. One W., attorney for plaintiff, asked for allowance of an attorney fee of \$1,100, which was denied by the lower court, and an appeal taken.]

START, C. J. This action was brought under General Statutes 1894, chapter 76, for the purpose of enforcing the stockholders' liability, and was prosecuted by the plaintiff on behalf of himself and all other creditors of the defendant corporation. Other creditors intervened, and proved their claims, and the action was prosecuted to final judgment against the stockholders. As a result of the prosecution of the action, there will be realized a common fund amounting to over \$13,000, which will be available for distribution to the several creditors. The attorney for the plaintiff petitioned the trial court for an allowance out of this fund for his services in prosecuting the action. No objection was or is here made on the ground that the allowance

should be made to the plaintiff, and not directly to his attorney. The court made its order denying the petition, stating, in a memorandum attached thereto, that there was nothing in the statute warranting the allowance, and no authority to sustain such a claim.

While the memorandum is no part of the order (see *Kertson v. Great Northern Exp. Co.*, 72 Minn. 378, 75 N. W. Rep. 600), yet it would seem, from the whole record, that the trial court must have denied the petition as a matter of strict legal right, and not as a matter of discretion. However this may be, we are of the opinion that, in the exercise of a sound discretion, the trial court ought to have allowed the petitioner a reasonable amount for his services. The power to make such an allowance does not depend upon any statute, but upon the equity rule that where one of many parties having a common interest in a trust fund, at his own expense, takes proper proceedings to collect it for the benefit of all interested in it, he is equitably entitled to reimbursement for his reasonable expenses in the proceedings out of the fund before its division. Now, no one creditor is entitled to enforce the liability of stockholders of a corporation for his own exclusive benefit. He must prosecute the action for the benefit of all creditors who elect to become parties to the action and exhibit their claims, and, where he assumes the burden of successfully prosecuting the action for the benefit of all, equity requires that he be reimbursed for his outlay from the common fund secured by his efforts. *Seibert v. Minneapolis & St. L. Ry. Co.*, 58 Minn. 39, 59 N. W. Rep. 822; *Dwinnell v. Badger*, 74 Minn. 405, 77 N. W. Rep. 219.

The correctness of this proposition is substantially conceded by the respondent, Watson S. Moore, but he claims that it would be inequitable to grant the petition in this case as against him, because he is both a creditor and a stockholder of the corporation; that nearly all of the money to be brought into the common fund by the plaintiff's action will be contributed by him as a stockholder; that approximately two-thirds of the fund will be distributed to him as a creditor, as an offset *pro tanto* to his stock liability, and that the plaintiff and his attorney opposed the allowance of his claim as a creditor, taking an appeal from its allowance to this court (see *Helm v. Smith-Fee Co.*, 76 Minn. 328, 79 N. W. Rep. 313); therefore, he ought not to be compelled, as such creditor, to pay the petitioner, as attorney for the other creditors, for his services in opposing his claim. This is a good reason why the whole amount of the petitioner's fees as attorney in the action ought not to be paid from the common fund, but it is no reason for refusing him any compensation whatever. The undisputed evidence in this case shows that it would be inequitable to allow the entire amount of the reasonable value of the services rendered by the plaintiff's attorney in this action out of the common fund, and that his claim should be liberally reduced. On the other hand, it is equally clear from the evidence that he is entitled to an allowance for such services as were rendered for the common benefit of all the creditors.

*Reversed.*



# APPENDIX OF FORMS.

## FORM I.

### SUBSCRIPTION TO CAPITAL STOCK<sup>1</sup>

#### PRIOR TO ORGANIZATION OF COMPANY.

Whereas, It is proposed to organize under the laws of the state of Delaware, a corporation to be known as ———, or by such other name as the parties in interest may determine; and

Whereas, It is proposed that said company shall have a capital stock of ——— dollars, and shall transact the business of ———.

Now, therefore, the signers hereto, in consideration of their mutual promises, do severally agree to and with each other, and with ———, the promoter and founder of said company, that they will take, and they do hereby severally subscribe to the capital stock of said company to the amount of the par value of stock set opposite their respective names.

This agreement is conditioned upon the procuring by said ——— of subscriptions of at least ——— dollars to said capital stock.

Dated at ———.

Witness:

NAME.	AMOUNT.
_____	_____
_____	_____
_____	_____
_____	_____
_____	_____

## FORM II.

### SUBSCRIPTION TO STOCK IN CORPORATION TO BE FORMED.

See *supra*, p. 510.

*Note.* See cases, *supra*, pp. 471-510.

<sup>1</sup> Copy furnished by Delaware Charter, Guarantee and Trust Company, Wilmington, Del. See form II, next, and paragraph 1, form XVI, *infra*. The forms herein printed, numbered I, VI, VIII, IX, X, XI, XII, XIII, XV and XVI, were all furnished by the Delaware Charter, Guarantee and Trust Company, and are printed by their permission. They furnish such forms to those who wish to incorporate under the Delaware laws, and have an office in that state with them.

## FORM III.

## STATUTORY SUBSCRIPTION.

See *supra*, p. 459.

## FORM IV.

## CONDITIONAL SUBSCRIPTIONS.

See *supra*, pp. 460, 522, 526, 529.

## FORM V.

## APPLICATION FOR INCORPORATION.

See *supra*, p. 436.

## FORM VI.

CERTIFICATE OF INCORPORATION<sup>1</sup>

OF ——— COMPANY.

*First.* The name of this corporation is ———.

*Second.* Its principal office and place of business in the state of Delaware is to be located in the city of Wilmington, county of New Castle. The agent in charge thereof is the Delaware Charter, Guarantee and Trust Company.

*Third.* The nature of the business and the objects and purposes proposed to be transacted, promoted and carried on, are to do any or all of the things herein mentioned, as fully and to the same extent as natural persons might or could do, and in any part of the world, viz: ———.

In furtherance and not in limitation of the general powers conferred by the laws of the state of Delaware, and the objects and purposes herein set forth, it is expressly provided that this corporation shall also have the following powers, viz:

To take, own, hold, deal in, mortgage or otherwise lien, and to lease, sell, exchange, transfer, or in any manner whatever dispose of real property, within or without the state of Delaware, wherever situated.

To manufacture, purchase or acquire in any lawful manner, and to hold, own, mortgage, pledge, sell, transfer, or in any manner dispose of, and to deal and trade in goods, wares, merchandise and property of any and every class and description, and in any part of the world.

To acquire the good-will, rights and property of any person, firm, association or corporation; to pay for the same in cash, the stock of this company, bonds or otherwise; to hold or in any manner to dispose of the whole or any part of the property so purchased; to conduct in any lawful manner the whole or any part of any business so acquired, and to exercise all the powers necessary or convenient in and about the conduct and management of such business.

To apply for, or in any manner to acquire, and to hold, own, use and operate, or to sell or in any manner dispose of, and to grant license or other rights in respect of, and in any manner deal with, any and all rights, inventions, improvements and processes used in connection with or secured under letters patent or copyrights of the United States or other countries, and to

<sup>1</sup> See Forms V and VII, and paragraph 2, Form XVI.

work, operate or develop the same, and to carry on any business, manufacturing or otherwise, which may directly or indirectly effectuate these objects or any of them.

To purchase, hold, sell, assign, transfer, mortgage, pledge or otherwise dispose of, the shares of the capital stock of, or any bonds, securities or evidences of indebtedness created by any other corporation or corporations of this state or any other state, country, nation or government, and while owner of said stock may exercise all the rights, powers and privileges of ownership, including the right to vote thereon, to the same extent as natural persons might or could do.

To enter into, make and perform contracts of every kind with any person, firm, association or corporation, municipality, body politic, county, territory, state, government or colony or dependency thereof, and without limit as to amount to draw, make, accept, indorse, discount, execute and issue promissory notes, drafts, bills of exchange, warrants, bonds, debentures, and other negotiable or transferable instruments and evidences of indebtedness, whether secured by mortgage or otherwise, as well as to secure the same by mortgage or otherwise, so far as may be permitted by the laws of the state of Delaware.

To have offices, conduct its business and promote its objects within and without the state of Delaware, in other states, the District of Columbia, the territories and colonies of the United States and in foreign countries.

To do any or all of the things herein set forth to the same extent as natural persons might or could do, and in any part of the world, as principals, agents, contractors, trustees or otherwise, and either alone or in company with others.

In general to carry on any other business in connection therewith, whether manufacturing or otherwise, not forbidden by the laws of the state of Delaware, and with all the powers conferred upon corporations by the laws of the state of Delaware.

*Fourth.* The amount of the total authorized capital stock of this corporation is \_\_\_\_\_ dollars (\$\_\_\_\_), divided into \_\_\_\_\_ shares, of \_\_\_\_\_ dollars (\$\_\_\_\_) each.

The amount of capital stock with which it will commence business is \_\_\_\_\_ dollars (\$\_\_\_\_), being \_\_\_\_\_ shares, of \_\_\_\_\_ dollars (\$\_\_\_\_) each.

*Fifth.* The names and places of residence of each of the subscribers to the capital stock are as follows:

NAME.	RESIDENCE.
_____	_____
_____	_____
_____	_____

*Sixth.* The existence of this corporation is to be perpetual.

*Seventh.* The affairs of this corporation are to be conducted by a board of not less than three directors, the number to be determined by the by-laws and elected at such times and places as may be determined in the by-laws, and the said directors shall appoint or elect such officers as the by-laws may prescribe.

*Eighth.* This corporation may become seized and possessed of either real or personal estate, or both, to the value of \_\_\_\_\_ dollars.



*Ninth.* The highest amount of indebtedness or liability which this corporation may at any time incur shall be ——— dollars.

*Tenth.* The private property of the stockholders shall not be subject to the payment of corporate debts to any extent whatever.

*Eleventh.* The directors shall have power to make and to alter or amend the by-laws; to fix the amount to be reserved as working capital, and to authorize, and cause to be executed, mortgages and liens, without limit as to amount, upon the property and franchises of this corporation.

With the consent in writing, and pursuant to a vote of the holders of ——— per cent. of the capital stock issued and outstanding, the directors shall have authority to dispose, in any manner, of the whole property of this corporation.

The by-laws shall determine whether and to what extent the accounts and books of this corporation, or any of them, shall be open to the inspection of the stockholders; and no stockholder shall have any right of inspecting any account, or book, or document of this corporation, except as conferred by law or the by-laws, or by resolution of the stockholders.

The stockholders and directors shall have power to hold their meetings and keep the books, documents and papers of the corporation outside of the state of Delaware, at such places as may be from time to time designated by the by-laws or by resolution of the stockholders, except as otherwise required by the laws of Delaware.

It is the intention that the objects, purposes and powers specified in the third paragraph hereof shall, except where otherwise specified in said paragraph, be nowise limited or restricted by reference to or inference from the terms of any other clause or paragraph in this certificate of incorporation, but that the objects, purposes and powers specified in the third paragraph, and in each of the clauses or paragraphs of this charter, shall be regarded as independent objects, purposes and powers.

We, the undersigned, for the purpose of forming a corporation under the laws of the state of Delaware, do make, record and file this certificate, and do certify that the facts herein stated are true; and we have accordingly hereunto set our respective hands and seals.

Dated at ———, ———.

———, 19——.

In presence of ———.

——— [SEAL.]

——— [SEAL.]

——— [SEAL.]

State of ———, }  
County of ——— } ss.

Be it remembered, that on this ——— day of ———, A. D. ———, personally appeared before me ———, parties to the foregoing certificate of incorporation, known to me personally to be such, and I, having first made known to them and each of them the contents of said certificate, they did each severally acknowledge that they signed, sealed and delivered the same as their several voluntary act and deed, and each deposed that the facts therein stated were truly set forth.

Given under my hand and seal of office, the day and year aforesaid.

[SEAL.]

———

## FORM VII.

CHARTER OF U. S. STEEL CORPORATION.<sup>1</sup>

## AMENDED CERTIFICATE OF INCORPORATION OF UNITED STATES STEEL CORPORATION.

We, the undersigned, in order to form a corporation for the purposes hereinafter stated, under and pursuant to the provisions of the act of the legislature of the state of New Jersey, entitled "An Act Concerning Corporations (Revision of 1896)," and the acts amendatory thereof and supplementary thereto, do hereby certify as follows:

## I. The name of the corporation is

UNITED STATES STEEL CORPORATION.

II. The location of its principal office in the state of New Jersey is at No. 51 Newark street, in the city of Hoboken, county of Hudson. The name of the agent therein and in charge thereof, upon whom process against the corporation may be served, is Hudson Trust Company. Said office is to be the registered office of said corporation.

## III. The objects for which the corporation is formed are:

To manufacture iron, steel, manganese, coke, copper, lumber and other materials, and all or any articles consisting, or partly consisting, of iron, steel, copper, wood or other materials, and all or any products thereof.

To acquire, own, lease, occupy, use or develop any lands containing coal or iron, manganese, stone or other ores, or oil, and any woodlands, or other lands, for any purpose of the company.

To mine or otherwise to extract or remove coal, ores, stone and other minerals and timber from any lands owned, acquired, leased, or occupied by the company, or from any other lands.

To buy and sell, or otherwise to deal or to traffic in, iron, steel, manganese, copper, stone, ores, coal, coke, wood, lumber and other materials, and any of the products thereof, and any articles consisting, or partly consisting thereof.

To construct bridges, buildings, machinery, ships, boats, engines, cars and other equipment, railroads, docks, slips, elevators, water-works, gas-works and electric-works, viaducts, aqueducts, canals and other water-ways, and any other means of transportation, and to sell the same, or otherwise dispose thereof, or to maintain and operate the same, except that the company shall not maintain or operate any railroad or canal in the state of New Jersey.

To apply for, obtain, register, purchase, lease, or otherwise to acquire, and to hold, use, own, operate and introduce, and to sell, assign, or otherwise to dispose of, any trade-marks, trade names, patents, inventions, improvements and processes used in connection with, or secured under letters patent of the United States, or elsewhere, or otherwise; and to use, exercise, develop, grant licenses in respect of, or otherwise turn to account any such trade-marks, patents, licenses, processes and the like, or any such property or rights.

To engage in any other manufacturing, mining, construction or transportation business of any kind or character whatsoever, and to that end to acquire, hold, own and dispose of any and all property, assets, stocks, bonds and

<sup>1</sup>Printed by permission from copy sent by J. P. Morgan & Co.

rights of any and every kind; but not to engage in any business hereunder which shall require the exercise of the right of eminent domain within the state of New Jersey.

To acquire by purchase, subscription or otherwise, and to hold or to dispose of, stocks, bonds or any other obligations of any corporation formed for, or then or theretofore engaged in or pursuing, any one or more of the kinds of business, purposes, objects or operations above indicated, or owning or holding any property of any kind herein mentioned; or of any corporation owning or holding the stocks or the obligations of any such corporation.

To hold for investment, or otherwise to use, sell or dispose of, any stocks, bonds or other obligations of any such other corporation; to aid in any manner any corporation whose stock, bonds or other obligations are held or are in any manner guaranteed by the company, and to do any other acts or things for the preservation, protection, improvement, or enhancement of the value of any such stock, bonds or other obligations, or to do any acts or things designed for any such purpose; and, while owner of any such stocks, bonds or other obligations, to exercise all the rights, powers and privileges of ownership thereof, and to exercise any and all voting power thereon.

The business or purpose of the company is from time to time to do any one or more of the acts and things herein set forth; and it may conduct its business in other states and in the territories and in foreign countries, and may have one office or more than one office, and keep the books of the company outside of the state of New Jersey, except as otherwise may be provided by law; and may hold, purchase, mortgage and convey real and personal property either in or out of the state of New Jersey.

Without in any particular limiting any of the objects and powers of the corporation, it is hereby expressly declared and provided that the corporation shall have power to issue bonds and other obligations, in payment for property purchased or acquired by it, or for any other object in or about its business; to mortgage or pledge any stock, bonds or other obligations, or any property which may be acquired by it, to secure any bonds or other obligations by it issued or incurred; to guarantee any dividends or bonds or contracts or other obligations; to make and perform contracts of any kind and description; and in carrying on its business, or for the purpose of attaining or furthering any of its objects, to do any and all other acts and things, and to exercise any and all other powers which a copartnership or natural person could do and exercise, and which now or hereafter may be authorized by law.

IV. The total authorized capital stock of the corporation is eleven hundred million dollars (\$1,100,000,000), divided into eleven million shares of the par value of one hundred dollars each. Of such total authorized capital stock, five million five hundred thousand shares, amounting to five hundred and fifty million dollars, shall be preferred stock, and five million five hundred thousand shares, amounting to five hundred and fifty million dollars, shall be common stock.

From time to time, the preferred stock and the common stock may be increased according to law, and may be issued in such amounts and proportions as shall be determined by the board of directors, and as may be permitted by law.

The holders of the preferred stock shall be entitled to receive when and as declared, from the surplus or net profits of the corporation, yearly dividends at the rate of seven per centum per annum, and no more, payable quarterly on dates to be fixed by the by-laws. The dividends on the preferred stock shall be cumulative, and shall be payable before any dividends on the common stock shall be paid or set apart; so that, if in any year dividends amounting to seven per cent. shall not have been paid thereon, the deficiency shall be payable before any dividends shall be paid upon or set apart for the common stock.

Whenever all cumulative dividends on the preferred stock for all previous years shall have been declared and shall have become payable, and the accrued quarterly installments for the current year shall have been declared, and the company shall have paid such cumulative dividends for previous years and such accrued quarterly installments, or shall have set aside from its surplus or net profits a sum sufficient for the payment thereof, the board of directors may declare dividends on the common stock, payable then or thereafter, out of any remaining surplus or net profits.

In the event of any liquidation or dissolution or winding up (whether voluntary or involuntary) of the corporation, the holders of the preferred stock shall be entitled to be paid in full both the par amount of their shares and the unpaid dividends accrued thereon before any amount shall be paid to the holders of the common stock; and after the payment to the holders of the preferred stock of its par value, and the unpaid accrued dividends thereon, the remaining assets and funds shall be divided and paid to the holders of the common stock according to their respective shares.

V. The names and post-office addresses of the incorporators, and the number of shares of stock for which severally and respectively we do hereby subscribe (the aggregate of our said subscriptions being three thousand dollars, is the amount of capital stock with which the corporation will commence business), are as follows:

Name.	Post-Office Address.	Number of Shares.	
		Preferred Stock.	Common Stock.
Charles C. Cluff, 51 Newark St., Hoboken, N. J.....		5	5
William J. Curtis, 51 Newark St., Hoboken, N. J.....		5	5
Charles MacVeagh, 51 Newark St., Hoboken, N. J.....		5	5

VI. The duration of the corporation shall be perpetual.

VII. The number of directors of the company shall be fixed from time to time by the by-laws; but the number, if fixed at more than three, shall be some multiple of three. The directors shall be classified with respect to the time for which they shall severally hold office by dividing them into three classes, each consisting of one-third of the whole number of the board of directors. The directors of the first class shall be elected for a term of one year; the directors of the second class for a term of two years; and the directors of the third class for a term of three years; and at each annual election the successors to the class of directors whose terms shall expire in that year shall be elected to hold office for the term of three years, so that the term of office of one class of directors shall expire in each year.

The number of the directors may be increased as may be provided in the by-laws. In case of any increase of the number of the directors the additional directors shall be elected as may be provided in the by-laws, by the directors or by the stockholders at an annual or special meeting; and one-third of their number shall be elected for the then unexpired portion of the term of the directors of the first class, one-third of their number for the unexpired portion of the term of the directors of the second class, and one-third of their number for the unexpired portion of the term of the directors of the third class, so that each class of directors shall be increased equally.

In case of any vacancy in any class of directors through death, resignation, disqualification or other cause, the remaining directors, by affirmative vote of a majority of the board of directors, may elect a successor to hold office for the unexpired portion of the term of the director whose place shall be vacant, and until the election of a successor.

The board of directors shall have power to hold their meetings outside of the state of New Jersey at such places as from time to time may be designated by the by-laws or by resolution of the board. The by-laws may prescribe the number of directors necessary to constitute a quorum of the board of directors, which number may be less than a majority of the whole number of the directors.

Unless authorized by votes given in person or by proxy by stockholders holding at least two-thirds of the capital stock of the corporation, which is represented and voted upon in person or by proxy at a meeting specially called for that purpose, or at an annual meeting, the board of directors shall not mortgage or pledge any of its real property, or any shares of the capital stock of any other corporation; but this prohibition shall not be construed to apply to the execution of any purchase-money mortgage or any other purchase-money lien. As authorized by the act of the legislature of the state of New Jersey, passed March 22, 1901, amending the seventeenth section of the act concerning corporations (revision of 1896), any action which theretofore required the consent of the holders of two-thirds of the stock at any meeting after notice to them given, or required their consent in writing to be filed, may be taken upon the consent of, and the consent given and filed by the holders of two-thirds of the stock of each class represented at such meeting in person or by proxy.

Any officer elected or appointed by the board of directors may be removed at any time by the affirmative vote of a majority of the whole board of directors. Any other officer or employe of the company may be removed at any time by vote of the board of directors, or by any committee or superior officer upon whom such power of removal may be conferred by the by-laws or by vote of the board of directors.

The board of directors, by the affirmative vote of a majority of the whole board, may appoint from the directors an executive committee, of which a majority shall constitute a quorum; and to such extent as shall be provided in the by-laws, such committee shall have and may exercise all or any of the powers of the board of directors, including power to cause the seal of the corporation to be affixed to all papers that may require it.

The board of directors, by the affirmative vote of a majority of the whole board, may appoint any other standing committees, and such standing com-

mittees shall have and may exercise such powers as shall be conferred or authorized by the by-laws.

The board of directors may appoint not only other officers of the company, but also one or more vice-presidents, one or more assistant treasurers, and one or more assistant secretaries; and, to the extent provided in the by-laws, the persons so appointed respectively shall have and may exercise all the powers of the president, of the treasurer and of the secretary, respectively.

The board of directors shall have power from time [to time] to fix and to determine and to vary the amount of the working capital of the company; and to direct and determine the use and disposition of any surplus or net profits over and above the capital stock paid in; and in its discretion the board of directors may use and apply any such surplus or accumulated profits in purchasing or acquiring its bonds or other obligations, or shares of its own capital stock, to such extent and in such manner and upon such terms as the board of directors shall deem expedient; but shares of such capital stock so purchased or acquired may be resold, unless such shares shall have been retired for the purpose of decreasing the company's capital stock as provided by law.

The board of directors from time to time shall determine whether and to what extent, and at what times and places, and under what conditions and regulations, the accounts and books of the corporation, or any of them, shall be open to the inspection of the stockholders, and no stockholder shall have any right to inspect any account or book or document of the corporation, except as conferred by statute or authorized by the board of directors, or by a resolution of the stockholders.

Subject always to by-laws made by the stockholders, the board of directors may make by-laws, and, from time to time, may alter, amend or repeal any by-laws; but any by-laws made by the board of directors may be altered or repealed by the stockholders at any annual meeting, or at any special meeting, provided notice of such proposed alteration or repeal be included in the notice of the meeting.

In witness whereof, We have hereunto set our hands and seals the 23d day of February, 1901.

CHARLES C. CLUFF. [L. S.]  
WILLIAM J. CURTIS. [L. S.]  
CHARLES MACVEAGH. [L. S.]

Signed, sealed and delivered

in the presence of

FRANCIS LYNDE STETSON.

VICTOR MORAWETZ.

State of New Jersey, } ss.:  
County of Hudson, }

Be it remembered, that on this 23d day of February, 1901, before the undersigned, personally appeared Charles C. Cluff, William J. Curtis and Charles MacVeagh, who, I am satisfied, are the persons named in and who executed the foregoing certificate; and I, having first made known to them, and to each of them, the contents thereof, they did each acknowledge that they signed, sealed and delivered the same as their voluntary act and deed.

GEORGE HOLMES,  
Master in Chancery of New Jersey.



[10 cent internal revenue stamp canceled.]

Indorsed. "Received in the Hudson Co., N. J., clerk's office Feb'y 25th, A. D. 1901, and recorded in Clerk's Record No. —, on page —.

"MAURICE J. STACK, Clerk."

Indorsed. "Filed Feb'y 25, 1901.

"GEORGE WURTS, Secretary of State."

[Indorsed: United States Steel Corporation. Amended Certificate of Incorporation filed in office of secretary of state April 1, 1901.]

#### FORM VIII.

#### WAIVER OF NOTICE<sup>1</sup>

OF FIRST MEETING OF INCORPORATORS OF ——— COMPANY.

We the undersigned, being all the parties named in the certificate of incorporation of the ———, incorporated under the laws of the state of Delaware, and having its principal office in the state of Delaware with the Delaware Charter, Guarantee and Trust Company, at Wilmington, Delaware, do hereby waive notice of the time, place and purpose of the first meeting of said corporation, and do fix the — day of — 19—, at — o'clock in the — noon, as the time, and the office of the Delaware Charter, Guarantee and Trust Company, in the city of Wilmington, state of Delaware, as the place of said first meeting of the corporation.

And we do hereby waive all the requirements of the statutes of Delaware as to the notice of this meeting, and the publication and service thereof; and we do consent to the transaction of such business as may come before said meeting.

Dated — 19—.

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

#### FORM IX.

#### PROXY, FIRST MEETING OF INCORPORATORS<sup>2</sup>

OF THE ——— COMPANY.

Know all men by these presents, That I, the undersigned, being one of the incorporators, a subscriber for and the owner of — shares of the capital stock of the corporation above named, incorporated under the laws of Delaware, do hereby constitute and appoint — my true and lawful attorney, in my name, place and stead, to vote upon the stock owned by me or standing in my name, as my proxy, at the first meeting of the said corporation, to be held at the company's office, Wilmington, Delaware, on the — day of —, or on such other day as the meeting may be thereafter held by adjournment or otherwise, according to the number of votes I am now or may then be entitled to cast, hereby granting the said attorney full power and

<sup>1</sup> See paragraph 3, Form XVI, *infra*.    <sup>2</sup> See paragraph 4, Form XVI, *infra*.

authority to act for me in my name at the said meeting or meetings, in voting for directors of the said company or otherwise, and in the transaction of such other business as may come before the meeting, as fully as I could do if personally present, with full power of substitution and revocation, hereby ratifying all that my said attorney or substitute may do in my place, name and stead.

In witness whereof, I have hereunto set my hand and seal, this \_\_\_\_\_ day of \_\_\_\_\_.

Witness.

[Internal revenue stamp, 25 cts.]

\_\_\_\_\_ [SEAL.]

#### FORM X.

### ASSIGNMENT OF SUBSCRIPTION TO STOCK<sup>1</sup>

IN THE \_\_\_\_\_ COMPANY.

Know all men by these presents,

That I, \_\_\_\_\_, in consideration of one dollar, lawful money of the United States, to me paid before the ensealing and delivery of these presents, the receipt whereof is hereby acknowledged, and for other good and valuable considerations, have sold, assigned, transferred and set over, and by these presents do sell, assign, transfer and set over unto \_\_\_\_\_ my right, title and interest as a subscriber to and an incorporator of the \_\_\_\_\_ company, a corporation organized under the laws of the state of Delaware, to the extent of \_\_\_\_\_ shares, and I do hereby request and direct the said company to issue the certificate for said \_\_\_\_\_ shares to and in the name of said \_\_\_\_\_ or such other person as he may name.

In witness whereof, I have hereunto set my hand and seal, this \_\_\_\_\_ day of \_\_\_\_\_.

\_\_\_\_\_ [SEAL.]

Sealed and delivered in the presence of \_\_\_\_\_.

[Internal revenue stamp.]

#### FORM XI.

### WAIVER OF NOTICE<sup>2</sup>

OF MEETING TO CONSIDER THE QUESTION OF INCREASING THE CAPITAL STOCK OF \_\_\_\_\_ COMPANY.

We, the undersigned, being all the incorporators and subscribers to the capital stock of \_\_\_\_\_ company, incorporated under the laws of the state of Delaware, do hereby waive notice of the time and place of a meeting for the purpose of considering the advisability of increasing the company's capital stock and the number of shares therein, and do hereby waive all statutory requirements as to publication or service of such notice; and we do hereby consent that said matters be considered at a meeting of the corporation to be held on \_\_\_\_\_ the \_\_\_\_\_ day of \_\_\_\_\_ 19—, at \_\_\_\_\_ o'clock, in the \_\_\_\_\_

<sup>1</sup> See paragraph 5, Form XVI, *infra*. <sup>2</sup> See paragraph 6, Form XVI, *infra*.

noon, and do likewise consent and agree that at the said meeting, or at any other meeting, the board of directors be authorized, empowered and directed to take all proper steps in said matters and to increase the company's capital stock and the number of shares therein, until the same shall reach the amounts named in the company's certificate of incorporation as its total authorized capital stock, and that the said board of directors be authorized, empowered and directed to issue the additional shares of the company's capital stock, at such times and in such amounts as said board shall determine, up to the amount of the company's total authorized capital stock.

Dated at \_\_\_\_\_.

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

FORM XII.

WAIVER OF NOTICE<sup>1</sup>

OF ASSESSMENT OF BALANCE REMAINING UNPAID ON CAPITAL STOCK OF  
\_\_\_\_\_ COMPANY.

We, the undersigned, being all the incorporators and subscribers to the capital stock of \_\_\_\_\_ company, incorporated under the laws of the state of Delaware, do hereby waive notice of the time and place of a meeting, to consider the subject of assessing and calling for the balance remaining unpaid on said stock of said company, and do hereby waive all statutory requirements as to publication or service of such notice, and we do hereby consent that said matters be considered at a meeting of the incorporation to be held on \_\_\_\_\_ the \_\_\_\_\_ day of \_\_\_\_\_, 19\_\_\_\_, at \_\_\_\_\_ o'clock in the \_\_\_\_\_ noon, and do likewise consent and agree that at said meeting, or at any other meeting, the board of directors be authorized, empowered and directed to assess upon all stock, subscribed for or issued, the entire balance remaining unpaid thereon up to the par value thereof, and to assess and call for the payment of such sums without any notice whatever, by publication or otherwise, and do hereby waive all our rights to publication of notice of any such assessment, and all statutory requirements concerning such assessment, and do hereby consent and agree to pay the balance remaining unpaid on the shares of said stock of said company held by us respectively, up to the par value of said shares, without any such notice or publication whatever, and immediately upon demand of the board of directors.

Dated at \_\_\_\_\_.

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

<sup>1</sup> See paragraph 6, Form XVI, *infra*.

FORM XIII.  
BY-LAWS<sup>1</sup>  
OF THE ——— COMPANY.

NAME.

1. The title of this corporation is ———.

OFFICE.

2. The principal office of this corporation in Delaware shall be in Wilmington, Delaware, and it shall there be represented by the Delaware Charter, Guarantee and Trust Company.

SEAL.

3. The corporate seal of this corporation shall have inscribed thereon the name of this corporation and the year of its creation and ———.

STOCKHOLDERS' MEETINGS.

4. (a) The annual meetings of stockholders after the year ——— shall be held at ——— on the ——— of ——— in each year at ——— o'clock in the ——— noon, when they shall by plurality vote elect a board of directors for the ensuing year.

The polls shall remain open from ——— o'clock in the ———noon until ——— o'clock in the ———noon.

A majority in amount of the stock issued and outstanding shall constitute a quorum for an election or for the transaction of other business.

(b) Each stockholder shall be entitled to one vote, either in person or by proxy, for each share of stock registered in his name on the books of the corporation for twenty days preceding the meeting.

(c) Notice of the meetings and the conduct of the same shall be as prescribed by the board of directors.

(d) Special meetings of the stockholders shall be called by the secretary on the written request of two directors, or on the written request of the owners of a majority of the stock, by notice given to each stockholder at least three days prior to such meetings. Such notice shall briefly state the objects of such meetings, and no other business shall be transacted at such meeting.

DIRECTORS.

5. (a) The property and business of this corporation shall be managed by a board of at least ——— directors, and they shall hold office for one year and until their successors are elected and qualified.

(b) The board of directors may at any regular or special meeting increase its number by electing additional members from among the stockholders to hold office until the next meeting of stockholders or until their successors shall be elected, but the number of directors shall at no time be more than ———.

(c) If the office of any director becomes vacant by reason of death, resignation or otherwise, the remaining directors, though less than a quorum, may elect a successor or successors, who shall hold office for the unexpired term.

(d) Regular meetings of the directors shall be held at ——— on the ——— of each month at ——— o'clock in the ———noon, unless otherwise ordered by the board.

<sup>1</sup> See Form XIV, and paragraph 7, Form XVI, *infra*.

(e) Notice of such meetings shall be given to each director by the secretary, at least two days previous thereto.

(f) Special meetings may be called by the president on his own motion on one day's notice to each director.

(g) Special meetings shall be called in like manner by the president upon the written request of two members of the board.

(h) At any meeting of the board — members shall constitute a quorum for the transaction of business, but a less number may adjourn.

(i) The board of directors shall have power to elect or appoint all necessary officers and committees, to employ agents, factors, clerks and workmen, to require any of them to give such bond for the faithful discharge of their duties as may be deemed wise, to fix their compensation, to prescribe their duties, to dismiss any appointed officer or employe, and generally to control all the officers of the corporation.

(j) The board may delegate to any committee such powers as to the board may seem wise.

(k) The board of directors, in addition to the powers and authority expressly conferred upon them by these by-laws, may exercise all such powers and do all such things as may be exercised or done by the corporation, but subject, nevertheless, to the provisions of the law, of the charter, and of these by-laws.

(l) The order of business at the meetings of the board shall be as follows:

1. A quorum being present, the president shall call the board to order.
2. The minutes of last meeting shall be read and considered as approved, if there is no amendment offered.
3. Reports of officers.
4. Reports of committees.
5. Unfinished business.
6. Miscellaneous business.
7. New business.

#### OFFICERS.

6. The officers of the corporation shall be a president, a vice-president, a secretary, a treasurer, a general counsel, and such other officers as may from time to time be elected or appointed by the board of directors; the secretary and treasurer may be one and the same person.

#### PRESIDENT.

7. The president shall have such powers and perform such duties as the board of directors shall prescribe.

#### VICE-PRESIDENT.

8. In the absence of the president, the vice-president shall be vested with all his powers and perform all his duties.

#### SECRETARY, TREASURER AND COUNSEL.

9. The secretary, treasurer and general counsel shall have such powers and perform such duties as the board of directors shall prescribe.

#### OFFICER PRO TEM.

10. In the absence of any officer, the board of directors may delegate his powers and duties to any other officer, or to any director, for the time being.

**COMMITTEES.**

11. Standing and special committees shall have such powers and perform such duties as the board of directors shall prescribe.

**STOCK.**

12. The stock of the corporation shall be issued, transferred, canceled and replaced in accordance with such rules as the board of directors shall prescribe.

**CHECKS.**

13. All checks drawn against the funds of this corporation for an amount exceeding —— dollars, shall be countersigned by the president.

**CONTRACTS.**

14. No contract or agreement involving more than —— dollars, shall be entered into by this corporation except by a resolution of the board of directors.

**INSPECTION OF BOOKS AND ACCOUNTS.**

15. No stockholder owning less than —— per cent. of the capital stock of this corporation, unless said stockholder shall be a director of this corporation, shall be allowed to examine the books and accounts of this corporation, except by a resolution of the board of directors.

**WAIVER OF NOTICE.**

16. Any stockholder, officer or director may at any time waive any notice required to be given under these by-laws.

**NOTICE.**

17. Whenever, under the provisions of these by-laws, notice is required to be given to any director, officer or stockholder, it shall not be construed to be limited to personal notice, but such notice may be given in writing by depositing the same in the post-office or letter-box in a postpaid, sealed wrapper, addressed to such director, officer or stockholder at his or her address as the same appears in the books of the corporation, and the time when the same shall be mailed shall be deemed to be the time of the giving of such notice.

**ALTERATION AND AMENDMENT.**

18. The board of directors may, by a majority vote of the whole board, alter or amend these by-laws at any regular or special meeting, provided notice of such alteration or amendment has been given to each director at least three days prior to said meeting.

**FORM XIV.****GENERAL SCHEME FOR BY-LAWS.<sup>1</sup>****BY-LAWS OF THE —— COMPANY.****ARTICLE I. GENERAL.**

§ 1. Title or name of corporation.

§ 2. Offices: (a) Principal. (b) Other.

<sup>1</sup> This is meant to be an outline of points to be provided for by the by-laws. The terms of the by-laws will vary with the business or occasion. Many matters suggested here are provided for in statutes, and these should always be consulted.



- § 3. Seal: (a) Form and description. (b) Custodian.
- § 4. Interpretation of words, terms, etc., as used in these by-laws.
- § 5. Penalties for violation of by-laws by officers.
- § 6. Amendments: (a) By whom made. (b) Notice of. (c) Vote necessary.

## ARTICLE II. STOCK.

- § 1. Classes of stock: (a) Common. (b) Preferred. (c) Treasury.
- § 2. Preferred stock: (a) Amount. (b) Nature of preference: (1) as to dividends—cumulative or non-cumulative; (2) as to assets; (3) as to voting; (4) as to liabilities.
- § 3. Treasury stock: (a) Amount. (b) Disposal of. (c) Dividend. (d) Voting.
- § 4. Subscription to stock: (a) Acceptance of subscriptions made prior to incorporation. (b) Subscriptions after incorporation: (1) opening books; (2) agents in charge; (3) conditional subscriptions. (c) Payment of subscriptions. (d) Forfeiture for non-payment.
- § 5. Certificates of stock: (a) Who and when entitled to. (b) Form. (c) Signature. (d) Number. (e) Registration. (f) Form of indorsement for transfer. (g) Form of power of attorney to have transfer made on books. (h) Lost certificates.
- § 6. Transfers of stock: (a) Surrender and cancellation of certificates. (b) Registration on books. (c) Issue of new certificate. (d) Closing of books before elections and dividend days.
- § 7. Stock and transfer books: (a) Books to be kept. (b) Form. (c) Place or offices in which to be kept. (d) Custodian.

## ARTICLE III. STOCKHOLDERS.

- § 1. Meetings: (a) First or organizing: (1) how and by whom called; (2) waiver of notice; (3) who entitled to vote; (4) number of votes; (5) method of voting. (b) Annual, or regular: (1) time; (2) place. (c) Special or called: (1) authority to call; (2) time; (3) place.
- § 2. Notice of meetings: (a) Regular: (1) by whom given; (2) how given; (3) how long. (b) Called: (1) by whom given; (2) how given; (3) how long; (4) business to be done.
- § 3. Quorum: (a) Number of persons. (b) Number of shares.
- § 4. Organization of meeting: (a) Chairman or president. (b) Secretary. (c) Inspectors of election.
- § 5. Rules of order—parliamentary manual.
- § 6. Order of business: (a) Roll call. (b) Proof or waiver of notice of meeting. (c) Reading and approval or correction of minutes. (d) Reports of officers and committees. (e) Election of officers. (f) Unfinished business. (g) New business. (h) Adjournment.
- § 7. Voting: (a) Who entitled to. (b) Lists to be made by secretary for inspectors. (c) Method: (1) *viva voce*; (2) yeas and nays; (3) ballot. (d) Proxies: (1) form; (2) evidence; (3) filing and preserving. (e) Cumulative.
- § 8. Record: (a) Books. (b) Kept by secretary. (c) Custody.

## ARTICLE IV. DIRECTORS.

- § 1. Number.
- § 2. Qualifications: (a) Age. (b) Shareholders or not. (c) Residence or citizenship. (d) Holding other office. (e) Oath: (1) form; (2) before whom; (3) record of.
- § 3. Classification: (a) First. (b) Second. (c) Third,—or others.
- § 4. Term: (a) Date of beginning. (b) Duration. (c) Holding till successor qualified.
- § 5. Election: (a) Time. (b) Place. (c) Method: (1) selection of inspectors; (2) ballot or otherwise; (3) majority or plurality vote.
- § 6. Vacancies: (a) Entire board: (1) not to work dissolution; (2) special meeting for election to be called,—by whom,—notice of. (b) Partial for — months before end of term: (1) special election; (2) appointment. (c) Otherwise, by election by majority of remaining members of board.
- § 7. Removal: (a) By whom. (b) For what cause. (c) Hearing. (d) Record.
- § 8. Meetings: (a) Regular: (1) time; (2) place; (3) notice. (b) Special: (1) called by whom,—president; —any — members; (2) notice, time, place, business. (c) Quorum: (1) number; (2) lesser number may adjourn. (d) Voting: (1) in person; (2) by proxy. (e) Order of business: (1) roll-call; (2) minutes disposed of; (3) report of officers and committees; (4) unfinished business; (5) new business; (6) adjournment. (f) Record: (1) by whom kept; (2) access to by members.
- § 9. Powers: (a) General management. (b) Officers: (1) elect or appoint; (2) fix compensation; (3) direct and supervise; (4) remove. (c) By-laws: (1) may not (or may) amend or repeal the by-laws of the company; (2) make rules to regulate their own transactions. (d) Fix and establish offices. (e) Regulate inspection of books. (f) Make calls for payment on shares: (1) how; (2) how often; (3) notice of. (g) Contracts: (1) with the corporation; (2) between corporations having common directors, or in matters in which they are interested. (h) Fix working capital. (i) Declare dividends. (j) Regulate transfer of shares. (k) Delegation of authority.
- § 10. Compensation: (a) Amount. (b) By whom and how fixed.

## ARTICLE V. STANDING COMMITTEES.

- § 1. Executive: (a) Selection. (b) Qualification. (c) Term. (d) Powers. (e) Compensation. (f) Vacancies in.
- § 2. Finance: (a) Selection. (b) Qualification. (c) Term. (d) Powers. (e) Compensation. (f) Vacancies in.

## ARTICLE VI. OFFICERS IN GENERAL.

- § 1. Enumeration: (a) President. (b) Vice-presidents. (c) Chairman of stockholders' meetings. (d) Secretary. (e) Treasurer. (f) General manager. (g) General counsel. (h) Auditor. (i) Other.
- § 2. Qualifications: (a) Shareholder. (b) Residence. (c) Member of boards. (d) Bonds.

- § 3. Election: (a) By whom. (b) Time. (c) Place. (d) Method: (1) ballot; (2) *viva voce*; (3) in writing.
- § 4. Term: (a) Beginning. (b) Duration.
- § 5. Vacancies: (a) By whom filled, and for full term or unexpired term.
- § 6. Compensation: (a) By whom fixed. (b) How.
- § 7. Removal: (a) By whom. (b) How.

## ARTICLE VII. PARTICULAR OFFICERS.

- § 1. President: (a) Preside at meetings: (1) board; (2) stockholders; (3) committees.  
 (b) Sign: (1) certificates; (2) bills, notes, checks, contracts, deeds, etc.  
 (c) Exercise general supervision and direction of corporate affairs and officers.  
 (d) Report: (1) to annual meeting; (2) to board at any time.  
 (e) Compensation: (1) amount; or (2) fixed by whom.
- § 2. Vice-presidents: (a) Duties of each. (b) Compensation, etc.
- § 3. Chairman of stockholders' meeting: (a) Selection. (b) Functions.
- § 4. Secretary: (a) Keep minutes: (1) stockholders' meetings; (2) board meetings; (3) committee meetings. (b) Give notices: (1) elections; (2) meetings; (3) calls; (4) time of payment of dividends, etc. (c) Seal: (1) custody; (2) affix to documents requiring. (d) Stock certificate book: (1) prepare; (2) record certificates issued; (3) issue certificates,—countersign and seal the same; (4) record transfers; (5) cancel certificates surrendered. (e) Countersign with president certificates, contracts, etc., and affix the corporate seal. (f) Report: (1) to stockholders; (2) to board of directors; (3) to public officers as required by law. (g) Make lists of stockholders for inspectors. (h) Salary: (1) amount, or (2) by whom fixed.
- § 5. Treasurer: (a) Custody of money and corporate securities. (b) Keep books of accounts. (c) Deposits. (d) Indorse bills, notes, checks, etc., for collection. (e) Pay money on vouchers,—draw checks and bills for such purpose. (f) Report: (1) annual meeting; (2) board; (3) furnish information to secretary or auditor for public reports. (h) Bond: (1) amount; (2) sureties; (3) filing or custody. (i) Salary.
- § 6. General manager: (a) Manage business under supervision of board. (b) Reports: (1) annual; (2) to board. (c) Contract: (1) supplies; (2) labor, etc. (d) Term of service. (e) Salary: (1) amount, (2) or fixed by whom; (3) payment of.
- § 7. General counsel: (a) Legal documents: (1) prepare; (2) inspect and pass upon. (b) Advise officers upon legal matters concerning corporation. (c) Conduct litigation. (d) Compensation: (1) salary; (2) fees.
- § 8. Auditor: (a) Have charge of accounts: (1) fix forms of books and blanks; (2) direct what shall be kept; (3) supervise keeping them. (b) Examine books regularly every ——. (c) Verify assets of treasurer. (d) Report to board any delinquency or default. (e) Supervise taking of inventories. (f) Report: (1) annually; (2) to board; or (3) executive committee; or (4) president, at any time. (g) Advise with board and executive officers as to manner of keeping accounts. (h) Furnish information necessary for making public reports.

## ARTICLE VIII. FINANCES.

- § 1. Working capital: (a) Fixed by whom. (b) Limits as to amount. (c) Investment until needed. (d) Used for what.
- § 2. Indebtedness: (a) Limit as to amount. (b) Mortgage of real estate, or corporate securities, consent of shareholders.
- § 3. Sinking fund: (a) Amount. (b) How accumulated. (c) For what purpose. (d) When and how to be paid.
- § 4. Dividends: (a) Declaration of: (1) by whom; (2) how; (3) out of what; (4) when payable; (5) closing transfer books before.
- § 5. Surplus: (a) Investment. (b) Disposition: (1) payment in money; (2) stock dividend.
- § 6. Deposit of funds: (a) In name of the company. (b) In what bank or banks.

## FORM XV.

MINUTES OF FIRST MEETING<sup>1</sup>

OF THE ——— COMPANY.

Minutes of the proceedings of the first meeting of the incorporators and subscribers to the capital stock of ———, held at the office of the Delaware Charter, Guarantee and Trust Company, Wilmington, Del., at ——— o'clock in the ———noon of ———, the ——— day of ———, 19—.

Present:

———— in person,  
 ——— in person,  
 ——— in person,  
 ——— by proxy to ———  
 ——— by proxy to ———  
 ——— by proxy to ———

being all the parties named in the certificate of incorporation, and all the subscribers to the capital stock of the company.

1. Mr. ——— was chosen temporary chairman, and Mr. ——— temporary secretary of the meeting.

2. The proxies were ordered placed on the files of the company.

3. A waiver of notice of the first meeting, signed by all the parties named in the certificate of incorporation, was read, and on motion duly made, seconded and carried, was directed to be entered in full in the minutes of the meeting.

It is as follows: (See Form VIII.)

4. A subscription to the capital stock of the company heretofore signed was presented and ordered spread upon the minutes.

It is as follows: (See Form I.)

5. A copy of the company's certificate of incorporation dated ———, 19—, filed in the office of the secretary of state of Delaware on the ——— day of ———, 19—, and recorded in the office of the recorder of deeds for New Castle county, Delaware, was presented, read and on motion duly made, seconded and carried, was directed to be placed on the files of the company and to be entered in full in the minutes of the meeting.

<sup>1</sup> See paragraph 8, Form XVI, *infra*.

Said certificate is so entered as follows: (See Form VI.)

6. A set of proposed by-laws, for the management of the company's property and the regulation and government of its affairs, was presented. On motion duly made, seconded and carried, the meeting proceeded to the consideration of the by-laws, article by article. On motions duly made, seconded and carried, each of the articles was separately adopted. Thereupon, on motion duly made, seconded and carried, the by-laws were adopted as a whole, and were ordered to be entered in full in the minutes.

They are so entered as follows: (See Form XIII.)

7. A "Waiver of notice of meeting to consider the question of increasing the company's capital stock and consent to such increase" (see Form XI), and a "Waiver of notice of assessment of balance remaining unpaid on the capital stock" (see Form XII), were presented, read, and on motion duly made, seconded and adopted, were ordered to be entered in full in the minutes of the meeting.

They are as follows: (See Forms XI and XII.)

8. Thereupon, on motion duly made, seconded and unanimously adopted, it was ordered and resolved that all persons hereafter subscribing to the capital stock of this company, or in any manner acquiring any share or shares of its capital stock, shall be deemed and considered to have done so with full notice and knowledge of, and fully consenting to, ratifying, approving and adopting the two waivers of notice and the consents last recorded; and that the directors of this company be, and they are hereby empowered, without any notice whatever, either to the present incorporators, subscribers or stockholders, or to any future subscribers or stockholders, to increase the capital stock of this company and to issue the same until it shall reach the amount named in the certificate of incorporation, and to make such increase at such times and in such amounts as they may deem wise, until the capital stock of this company is increased to ——— dollars, the sum named in the certificate of incorporation of this company as its total authorized capital stock; and that the directors be, and they are hereby authorized to assess, similarly, without notice or publication, upon each share of stock from time to time, when, and as they may deem proper, such sum or sums of money as the directors shall designate, not exceeding in the whole the balance remaining unpaid on said stock up to the par value thereof; and that said directors may, upon any default or delinquency in the payment of such assessment, or any part thereof, take any procedure which they might have taken had they given the notices specified in sections 27 and 29 of the general corporation law of Delaware, or in any other provision of the laws of said state.

9. Upon motion duly made, seconded and carried, it was resolved that the Delaware Charter, Guarantee and Trust Company be and it is hereby appointed the representative of this company in the state of Delaware, to maintain an office for this company in said state, to have an agent in charge thereof, to exhibit this company's sign on said office, as required by law, and to keep in said office such lists and copies of records as the statute of the state of Delaware may require to be kept in said state, and the secretary was ordered to send a copy of the foregoing resolution, duly certified by him, to the said Delaware Charter, Guarantee and Trust Company.

10. Mr. ——— presented a proposed contract for the acquirement by this company of certain property and rights, and the procurement of certain services and labor as more fully described in said contract. Said contract was read and ordered filed, and upon motion duly made, seconded and carried, it was recommended to the board of directors to enter into said contract on behalf of this company, and to issue the full-paid capital stock of this company to the amount of ——— dollars (\$——) in compensation therefor, provided that, in the judgment of the said board, said property and services are reasonably worth said sum to this company.

11. Upon motion, duly made and seconded, and by the affirmative vote of all present, the following preamble and resolution were adopted:

Whereas, It has been agreed between each of the incorporators and the parties to the aforesaid contract, that the stock to be issued in payment of the property and rights to be acquired, and the services and labor to be procured by the resolution set forth above, shall include the stock subscribed by the incorporators, as evidenced by the subscription to capital stock; Resolved, That the board of directors be and they are hereby authorized to accept said property as full payment of the subscriptions for stock of the incorporators, and to issue full-paid stock to the incorporators, or their assigns, to the amount of their respective subscriptions.

12. On motion duly made, seconded and carried, it was resolved that the board of directors be and it is hereby empowered to purchase, from time to time, such property and similarly to procure the performance of such services and labor as it may deem necessary for the company, and to issue in payment therefor such amount or amounts of the full-paid capital stock of this company as to the directors may seem fair and reasonable compensation for such property, services or labor.

13. On motion made, duly seconded and carried, the following assignments of stock were approved and accepted by the affirmative vote of all present.

——— to ——— of ——— shares.  
——— to ——— of ——— shares.  
——— to ——— of ——— shares.

14. On motion duly adopted, the stockholders proceeded to an election by ballot for directors of the company to hold office as such until the next annual meeting of the stockholders in 19—— and until their successors shall be chosen and qualified.

15. Said election resulted as follows:

Names.	Number of Votes Received.	Whole Number of Votes Cast.
--------	------------------------------	--------------------------------

16. The chairman thereupon declared that the following named persons had each been elected a director of the company to serve for said period, viz:  
———.

17. Thereupon, on motion duly made, seconded and carried, the meeting adjourned.

———, Temporary Secretary of the Meeting.



## FORM XVI.

DIRECTIONS FOR USING THE BLANK FORMS.<sup>1</sup>

## 1. "SUBSCRIPTION TO CAPITAL STOCK PRIOR TO ORGANIZATION"—FORM I, SUPRA.

This form is used to cover two requirements under the law; first, that the company should begin business with at least \$1,000 of capital stock, and second, that each director must be the owner of at least three shares of stock. These subscriptions, however, need not be paid until required by the board of directors. This subscription may, of course, be for as much capital stock as is required; only \$1,000, however, is necessary to qualify the company to begin business.

As each director is obliged to own three shares of stock, it is wise to have each person who expects to be elected as a director of the company, at its first meeting, to subscribe on this blank for at least three shares of the capital stock of the company. Should it not be practicable, however, to have each of the proposed directors to subscribe for the three shares necessary to qualify him to be elected as a director, then some other person could subscribe for three shares, or some other party subscribing may subscribe three shares extra, and assign the same to the proposed director before the first meeting of the corporation, according to "Form X," hereafter explained.

## 2. "CERTIFICATE OF INCORPORATION"—FORM VI, SUPRA.

In filling out section "third" of this form, state, if convenient to do so, the particular places at which the business is proposed to be carried on, then state fully the special objects and purposes to be transacted, promoted and carried on by the proposed corporation.

A number of "Special Object" forms will be found in our pamphlet, "Corporations under the Laws of Delaware," that may be useful and suggestive.

Filling out section "fourth" of this form is very simple, bearing in mind that the authorized capital stock must be at least \$2,000, and the amount of capital stock with which the company will commence business must be at least \$1,000.

Under section "fifth" place the name and post-office address of each incorporator, and while a majority only of the incorporators need to sign the certificate of incorporation, it is wise to insert here only the names of those who propose to sign the certificate of incorporation, and of these there must be at least three. Some amount should be stated, but there is no limit—any amount desirable may be inserted.

Under section "eleventh," a blank is left for including "any provision creating, defining, limiting and regulating the affairs of the corporation, the directors and the stockholders, or any classes of the stockholders, provided such provisions are not contrary to the laws of this state."

It is not often, however, that it will be desirable to add any provisions that are not already included in "Form VI," as issued by us.

The certificate is now dated and signed by at least three incorporators, and acknowledged before a commissioner of deeds for the state of Delaware, a notary public of any state or territory, or of the District of Columbia, or be-

<sup>1</sup> Furnished by the Delaware Charter, Guarantee and Trust Company, Wilmington, Delaware.

fore any other person authorized to take acknowledgment of deeds by the laws of the state of Delaware.

The certificate is then properly stamped under the war revenue act, and is ready to send to us.

3. "WAIVER OF NOTICE OF FIRST MEETING OF INCORPORATORS"—FORM VIII, SUPRA.

The first meeting of the incorporators may be called by a notice thereof published for two weeks, etc., or by a personal notice served upon all the parties named in the certificate of incorporation at least two days prior to the time of such meeting, or it may be called by consent, that is, by waiving the notice and fixing the time. This is done by means of this form, thereby saving the time and expense of personal notice or notice by publication.

The first meeting of incorporators can not be held until the certificate of incorporation has been filed with the secretary of state, and a certified copy thereof returned to us and entered for record in the recorder of deeds' office in and for New Castle county, and as it will take us at least two days to do this, be sure and make due allowance for this time in setting the date for the first meeting in filling up this form.

This form must be signed by each person who signs the certificate of incorporation.

4. "PROXY FOR FIRST MEETING OF INCORPORATORS"—FORM IX, SUPRA.

We advise that the first meeting of incorporators be held in this state, and as the incorporators may not be able to attend the first meeting, this form is prepared to enable them to have a proxy to act in their stead at such meeting. All of the incorporators may send proxies if they so desire, and on request we will send the names of satisfactory persons to act in their stead at the said meeting.

This form must be stamped in accordance with the war revenue act.

5. "ASSIGNMENT OF SUBSCRIPTION TO STOCK"—FORM X, SUPRA.

If it is desired to elect any one a director who has not subscribed to the capital stock in "Form I," then some person who has subscribed will use this form in assigning three shares to the person who is to be elected a director, so as to qualify him so to act. This company, if requested, will suggest the name of a satisfactory person to serve as resident Delaware director who can be qualified by having assigned to him the necessary shares of stock as before stated.

This form must be stamped in accordance with the war revenue act.

6. "WAIVERS OF NOTICES, AND ETC."—FORMS XI AND XII, SUPRA.

These two forms, like "Form VIII," are prepared for the purpose of saving the time, expense, etc., of publication required under the Delaware law, and we would advise their being signed, so as to enable the incorporators at the first meeting to fully qualify the board of directors to be elected, to carry out the purposes of the company without the necessity of calling a further meeting of the stockholders.

These forms must both be signed by all the incorporators.

## 7. "BY-LAWS"—FORM XIII, SUPRA.

We would suggest that a working set of by-laws be prepared in advance, that they may be adopted at the first meeting of the corporation without loss of time, etc. The set of by-laws which we submit is merely a suggestion to corporations and counsel, and can be revised and corrected to suit the circumstances of each case.

Should this set of by-laws be adopted, we will supply each of the directors with a copy, that he may have the by-laws of the company in convenient form.

## 8. "MINUTES OF FIRST MEETING"—FORM XV, SUPRA.

This form is prepared for the purpose of facilitating the work of the first meeting, and to help the temporary secretary in keeping the minutes of the same.

This form also can be corrected and revised to suit the circumstances of each case.

Should the incorporators be unable to come to Delaware to hold this meeting, they can send their proxies to such parties as we will name, and the meeting will be held and such action taken as may be prescribed by the prepared "Forms XIII and XIV."

Then, if desired, we will secure a minute-book for the company, and have the minutes of the first meeting properly entered therein, signed by the temporary secretary and forwarded to the company, which is then ready to elect officers and proceed to business.

*Note*, by Delaware Charter, Guarantee and Trust Company, Wilmington, Del.:

The use of these forms makes incorporating under the Delaware law a very simple matter, and enables persons desiring to incorporate under the Delaware law to do so without the loss of time and the expense of coming to Delaware to incorporate or to organize a corporation.

After the first meeting, the directors and stockholders may meet at any place that is stated in the by-laws.

When the blank forms are prepared to suit the circumstances of each case, send them to us with check for an amount to be ascertained upon the following basis:

Incorporating fee of fifteen (15) cents for each \$1,000 of capital stock, but in no case less than.....	\$20 00
Secretary of State's fee (about) (The amount of this item depends upon the number of pages in the charter).....	7 00
Recorder of Deeds' fee (about) (The amount of this item depends upon the number of pages in the charter).....	4 00
Fee to this company for one year's services.....	50 00
Charge for minute book, if secured by us as per directions under "Form XV".....	1 55
Charge for entering minutes, if entered by us as per directions under "Form XV".....	5 00

We will then attend to the filing, recording, and all other matters required to be done in Delaware for the company.

Should the parties in interest reside at different places and it should be inconvenient to get them together to sign the paper explained above, we will secure a charter for you without any action on your part other than forwarding to us the following:

1. "Form VI," filled out to suit the business to be carried on.
2. "Form XIII," corrected and filled out to suit your case.

3. "Form XV," completed to suit your wishes.

4. Check for expenses as shown above.

We will then have the papers signed by three parties here, and at the first meeting the aforesaid parties will assign the subscription to stock to such parties as you may name and elect them as a board of directors, and as a board of directors they can then meet at such places as may be designated in the by-laws and proceed with the business of the company.

#### FORM XVII.

#### OPTION CONTRACT.<sup>1</sup>

This agreement made at ——— this ——— day of ———, upon the various considerations herein named, and other good and valuable considerations, between the ——— company (herein called vendor), the stockholders thereof as individuals (herein called the stockholders, meaning thereby each one who signs this agreement as fully as if he was individually named in each provision of this agreement), of the one part, and ——— (herein called the purchaser), his nominee or assigns, of the other part, witnesseth:

Whereas, The said vendor is a corporation organized under the laws of ———, with a capital stock outstanding of \$——— divided into ——— shares of common stock, and ——— shares of preferred stock, each of the par value of \$———; and,

Whereas, It is deemed desirable to consolidate the property and business of certain companies engaged in manufacturing, etc., ———, located at ——— and ——— (enumerating them), or such of them and such others as may agree to come in upon such terms as contained herein, and to organize one corporation under the laws of the state of ———, for the purpose of acquiring and taking over the property and business of such companies upon the terms and conditions hereinafter contained as to each of said companies; and,

Whereas, The said purchaser proposes to form such a corporation under the laws of such state, to be called the ——— with a capital stock of about \$———, to be divided into shares of \$100 each, part to be ——— per cent. preferred (both as to capital upon dissolution, and cumulative as to dividends), and part to be common (the exact amount of such capital stock more or less than \$———), and the division (to be as nearly equal as possible) into preferred and common, to be determined by what shall be found necessary to acquire the

<sup>1</sup> Note. The promotion and organization of one corporation to take over the business of several others is a matter of so intricate a nature that it is difficult to provide forms that can be of much service—and the following Nos. XVII, XVIII, XIX, are given mainly by way of suggestions, which it is hoped will be helpful. They are designed only to illustrate one plan, viz: 1. Securing options; 2. Securing the assistance of bankers who form a syndicate for the purpose of furnishing for a commission the necessary cash; 3. Organizing the proposed corporation, with the proper amount of capital authorized, but with only such sum subscribed as is necessary to organize and select officers proper to contract in its name; 4. Making a contract with the promoter to exchange its stock for the property upon which he has options; 5. Simultaneous exchanges of stock and the conveyances necessary to complete the transaction. Perhaps the more usual plan now followed is for a syndicate to be first organized which undertakes the securing of the options, furnishing the funds, and organizing the corporation; under such plan the steps are substantially the same, and the forms could be varied to meet such conditions.

business of such companies, pay all expenses and commissions connected with the promotion, organization, and financing said ——— company, and provide it with not less than \$——— working capital; but no preferred stock of such ——— company shall be issued except in payment for real or personal property, or for cash received, equivalent in value to the face value of such preferred stock issued therefor.

Now, therefore,

I. *Option*: Said vendor, and said stockholders, in consideration of ——— dollars to it and them paid by said purchaser, and the other good and valuable considerations herein contained, sell to the purchaser who buys of the same, the sole option and privilege until the ——— day of ——— of purchasing, for the price to be determined and paid as hereinafter provided, all the property, real and personal, tangible and intangible, franchises, good-will, patents, trade-marks, processes (cash on hand, bills, notes and accounts receivable),<sup>1</sup> belonging to said vendor used in carrying on its business, set forth and described in the schedule hereinafter provided for, and made part hereof, and the shares of stock of said vendor held by the said stockholders.

II. *Date of transfer*: If said option is exercised, the sale may be completed on or before the ——— day of ——— (called the transfer day), which the board of directors of said vendor may extend for thirty days thereafter if necessary to complete such transfers. It is, however, understood that the sale shall be considered as taking effect at the date of completing the schedule hereinafter provided for, and no dividends shall be declared or paid, and no property contained in said schedule shall be disposed of thereafter, except in the ordinary course of business, previous to the completion of said transfer.

III. *Schedule*: Said vendor promises to execute and deliver to said purchaser, within ——— days after the date hereof, a complete schedule of the entire property which it proposes to sell to such purchaser, sufficiently describing each item thereof to identify it. Said schedule shall enumerate and value by the method hereinafter provided the tangible and intangible property separately; the tangible property shall include land, plants, materials, supplies and products, etc., on hand, to be separately itemized; there shall also be contained a full description of all patents or interests in patents belonging to said vendor, and the value thereof, together with a statement of the price asked for a general license to use the same by said purchaser; also, a list of all insurance policies upon the property meant to be sold hereby, with the amounts thereof and the date of expiration; also, all bills, notes and accounts receivable, with the amounts, rate of interest, and date when due; also a statement of all liens and incumbrances upon any of said property, together with the aggregate indebtedness of such vendor. Said schedule shall also contain a full and detailed statement of all items required for valuing such intangible property as the franchise, good-will, etc., of said vendor, in the manner hereinafter indicated. It shall also give a complete list of all shareholders of said vendor, with their residences, and the number of shares held by each. It shall also contain an express guaranty of the correctness of the facts stated therein.

IV. *Appraisal*: In order that there may be an uniform and just method of establishing the proper value of the various plants which it is proposed to

<sup>1</sup> Not usually included.

consolidate, said schedule shall be placed in the hands of ———, and ———, ———, ———, as a committee of experts and accountants, who shall verify the facts stated in such schedule, and for such purpose may have access to the books, papers, documents, etc., of said vendor, and may call for such other information necessary therefor. Each of said committee before entering upon such work, shall take an oath to perform faithfully all duties and obligations herein placed upon them, and especially to value the property of all vendors herein proposed to be consolidated, according to the methods herein prescribed, and to observe the obligation of secrecy as to the details thereof, as herein provided. Said committee shall make report in writing duly certified, as to their findings and valuations, and the same, unless otherwise herein provided, shall be binding on the parties hereto.

V. *The method of appraisal* shall be as follows: Land shall be valued at its actual market value without reference to the plants thereon, but consideration shall be given to its location and adaptability to the business. Plants, including buildings, machinery, appliances, etc., shall be appraised apart from the land, at their present value to a going concern, estimated by the present cost of construction at the place where located; materials, supplies and products on hand at the premises, or in transit thereto, at the cost to replace them at present prices at the location of said plant—but such changes shall be made therein at the time of transfer as shall be due to changes in quantities and market prices at that time.

Unexpired insurance of whatever kind shall be estimated at its pro rata value, to be changed at time of transfer to its proper pro rata value at that time.

Bills and notes shall be estimated at the present worth of their real value,—subject to such change as is proper at the time of transfer. Accounts receivable shall be valued at such per cent. of their face as the experience of the vendor for the past ——— years shall show are collectible. (Note: It is usually provided that bills, notes, cash and accounts, as they shall exist at the time of the option, shall remain with the vendor, to discharge any current obligations then existing, and after that for its own use.)

Said committee shall investigate the value of such patents and the price asked for a general license to use the same as contained in the schedule, in whatever way they deem most likely to ascertain the real value thereof, and shall report thereon,—but such report shall not be conclusive on the parties hereto.

The value of the franchise, good-will, etc., shall be estimated as follows: (1) The average yearly earnings of said vendor for the past ——— fiscal years shall be ascertained by adding together for each year the *net profits* of said vendor, and such of the following items as have been in each year charged against the earnings, in ascertaining the *net profits*, viz: interest on indebtedness; cost of insurance; items allowed, but not in fact paid out or incurred as a debt for depreciation; items for new construction; salaries and compensation paid to general officers, directors, general managers, superintendents, partners, auditors, cashiers, etc. (but not to foremen, clerks, employes, servants and laborers), and the amount for repairs, renewals and maintenance for each year; the sums so ascertained for each year shall then be added together



and the average taken. (2) From this average there shall be deducted a sum equal to — per cent. of the value of the land, and — per cent. of the value of the buildings, and — per cent. of the value of the machinery, tools, appliances, etc., as fixed by said committee; the remainder shall be considered the average net annual profits of said vendor; *provided*, however, that if for any year the figures for any item shall be found to be due to peculiar or extraordinary causes which are not permanent and no longer exist, the committee may reject such figures, or may use for such year such results as may fairly be due to usual and ordinary conditions. (3) The sum so ascertained multiplied by such multiplier as shall be found necessary to multiply the sum total of the net profits so ascertained of all the companies proposed herein to consolidate, in order to make the amount of common stock of the proposed new company approximately equal to its preferred stock, and also allow out of said total net profits as nearly as may be a dividend of — per cent. on such amount of common stock after paying the dividends on the preferred stock, shall be considered the value of said franchise, good-will, etc., of such vendor company.

VI. *Purchase-price*: The purchase-price to be paid said vendor by said purchaser, in case the option is exercised, shall be ascertained as follows: Any vendor whose net profits ascertained as above set forth (except the items for insurance and salaries shall be charged to expense accounts) shall be equal to or over 8 per cent. of the appraised value of the land, and plant, including tools, machinery, appliances, materials, supplies and products on hand of said vendor, shall receive for such property twelve and one-half times said profits, in cash or in fully paid preferred shares of said new company, as said vendor shall elect at the time notice of exercising the option is given. Any vendor whose net profits likewise ascertained shall be less than 8 per cent. of the appraised value of its land and plants, etc., shall receive in cash or preferred shares twelve and one-half times its said profits, and the balance of the appraised value of such land, and plants, including tools, etc., in common stock.

The purchase of all patented apparatus, machinery, etc., included in the property purchased shall include the right to use the same without any charge or royalty therefor, and the said purchaser may or may not, at his option, at the transfer day, purchase said patents or general license to use the same at the prices above set forth or then agreed upon, and pay therefor in — stock of said proposed company. Bills, notes, accounts, etc., and unexpired insurance, shall be taken at their value, estimated as above provided, as of the date of transfer, and be paid for either in cash or preferred stock, as the vendor shall then determine.

In case there are any liens upon any of said property, the said purchaser may retain of the purchase-price, if it is to be paid in cash, such sum as will, if put at — interest, amount to enough to discharge the same when due; or if to be paid in preferred stock, may retain an amount thereof equal to 125 per cent. of such lien until the same is due and paid. Also said purchaser may retain such an amount of the purchase-price as may be necessary to secure him against any defect of title or any other indebtedness not otherwise provided for, until the same is removed.

The entire value of the franchise, good-will, etc., ascertained as above provided, shall be paid for in the common stock of said proposed new company.

VII. *Destruction or loss of property*: If before the transfer of the property by the vendor, any part thereof shall be destroyed by fire or other casualty (in case the option is exercised), the same shall be fully restored or replaced by said vendor on or before the — day of —; and if not so done then the insurance (if any) collected therefor shall be paid to said purchaser, or the purchase-price to be paid shall be reduced by an amount equal to the appraised value of the property so destroyed, at the option of said purchaser.

VIII. *Assumption of contracts*: In case the option is exercised, all contracts *bona fide* made before by said vendor and existing at the transfer day, for the purchase, sale, or manufacture of materials or products shall be assigned to and assumed by said purchaser.

IX. *Vendor not to engage in like business*: As part of the consideration for said purchase, in case this option is exercised, said vendor and said stockholders shall on or before said transfer day execute and deliver, by depositing with the trust company hereinafter named, to said purchaser a contract or contracts (subject to assignment by him), by which said vendor and said stockholders each of them shall obligate themselves for a period of — years after said transfer day not to engage or become interested in, directly or indirectly, either as individuals, partners, stockholders, officers, factors, agents or employes, the same or similar business competing with that hereby agreed to be sold to the purchaser herein (except for him or his assigns) within the states of —.

X. *Delivery of papers*: The vendor upon — days' notice given by the purchaser shall deliver to the — Trust Company of —, complete abstracts of title to all real property agreed herein to be sold, wherever situated, prepared and duly searched to date of delivery (and in case of transfer, continued to the time thereof), by competent lawyers or title guarantee companies, and full and sufficient deeds, bills of sale, indorsements, assignments and all other necessary writings and conveyances, properly executed, stamped, acknowledged and certified, to make them valid and admissible to record where required, in order to convey all such property, and containing usual covenants and warranties that said property is free and clear of all incumbrances except as herein provided, or therein disclosed, and accompanied by title insurance policies and certificates of the — Title Insurance Company, disclosing the true condition of the title to such property in every particular.

Said vendor and stockholders shall also upon like notice deliver to said trust company the certificates of stock held by such stockholders, with proper assignments thereof in blank. Said trust company shall deliver to said vendor and said stockholders separately, receipts for all such title papers and stock certificates so deposited with it, and shall hold all such documents until the transfer day or until the expiration of said option.

XI. *Payment*: Upon the transfer day the said purchaser may pay or cause to be paid the purchase-price in cash or stock issued in such name as said vendor may designate, less any amount to be retained as security against debts or defective titles as hereinbefore provided, to said trust company, for

said vendor and stockholders, and thereupon shall be relieved from further obligation to said parties, except to pay any balance due when the matter of debts and defective titles shall be finally adjusted. Said trust company is hereby authorized at such transfer day, upon payment being so made, to deliver all abstracts, title papers, policies, contracts, assignments, writings, certificates of stock, etc., to said purchaser, or as he may direct. In case payment is to be made in stock, and permanent certificates are not at the transfer day ready for delivery, payment may be made in transferable scrip certificates exchangeable upon presentation, duly authenticated, at ———, for permanent certificates when they are ready for delivery.

XII. *Arbitration*: In case of disagreement as to the meaning or method of carrying out any of the provisions of this agreement, such difference shall be submitted to three disinterested persons, one chosen by said vendor, one by said purchaser, and the third by the two so chosen, and the award of the majority of such shall be final and conclusive on the parties hereto.

XIII. *Return of papers*: If the purchaser fails to exercise this option, said trust company shall return to the vendor and stockholders all such abstracts, title-papers, policies, contracts, certificates, etc., deposited with it, and said purchaser shall pay all the charges of said trust company, and it shall have no lien of any kind upon said papers or any part of them.

Said purchaser shall also, if said transfer is not completed, return to said vendor all schedules, appraisements, reports of committees, etc., within ——— days after the expiration of the option, and until said transfers are completed, the details of such schedules, appraisals, valuation reports and information put in the hands of the purchaser or the committee above mentioned (except the total sums to be paid for the real and personal property, franchise, etc., ascertained as above set forth), shall be considered and treated as private information given by each vendor only for the special purpose indicated herein, and shall not be made known to any of the other vendors or to outside parties.

XIV. *Assignment*: It is expressly understood that this instrument may be assigned by said purchaser, and when duly assigned all its provisions shall inure to the benefit of such assignee, and subject him to all liabilities arising thereunder, whereupon the rights and liabilities of the purchaser hereunder shall terminate.

XV. *Stockholders*: In consideration that the said purchaser shall deliver or cause to be delivered to said vendor, or the party designated by it, the purchase-price of said property herein agreed to be sold,—said purchaser to be in no way liable for the proper distribution of said purchase-price to said shareholders by said vendor,—the undersigned stockholders owning respectively the number of shares set opposite our several names, do each of us hereby agree to, approve, ratify and confirm the said proposed sale and transfer of the property of said vendor, and our shares of stock therein, upon the terms and conditions hereinbefore set forth.

In witness whereof, the parties hereto have hereunto set their hands and signatures on the day and year first above written.

—————, Purchaser.

—————, Vendor.

SHAREHOLDERS.

Name.	Residence.	Shares of Stock Now Held.	
		Preferred.	Common.

FORM XVIII.

UNDERWRITING CONTRACT.

This agreement made this — day of — by and between the parties hereinafter named witnesseth:

Whereas, — (herein called promoter), proposes to organize a corporation under the laws of the state of — to be known as the — Co. (herein called the corporation), for the purpose of acquiring the stock, property, and plants, and taking over and consolidating the business of companies engaged in —, named and located as follows: —. And which corporation shall have a capital stock of \$—— consisting of — shares of — per cent. preferred (as to capital, and cumulative as to dividends), and — shares of common stock; and,

Whereas, Said promoter has obtained options for the purchase of all of said property of said companies, at certain prices, to be paid for partly in cash and partly in preferred and common stock of said corporation; and,

Whereas, It will be necessary to provide at least \$ — in cash in order to complete said purchases and provide the necessary working capital for said corporation; and,

Whereas, It is deemed desirable to form a syndicate for the purpose of furnishing the cash required as above set forth, by underwriting and guaranteeing a subscription to the preferred stock of such corporation at its par value, which syndicate shall be composed of those who subscribe hereto as provided herein, and which syndicate shall be represented by the — bank of — as managers of such syndicate; and,

Whereas, Such syndicate for so underwriting, guaranteeing and furnishing the amount of cash hereinbefore specified, is to receive as a commission therefor from said promoter, \$—— of preferred, and \$—— common stock, both fully paid up and non-assessable, which commission, after paying the fees of the — bank above named, is to be divided among the undersigned subscribers in proportion to their subscriptions.

Now, therefore, in consideration of the premises, the undersigned subscribers, each desiring to become a member of such syndicate, and for himself severally and not jointly, to underwrite and guarantee the purchase and payment of said stock to the extent of his subscription hereto,

It is hereby agreed upon the considerations herein contained, and —

dollars by each paid to the other between said subscribers, said bank on behalf of such syndicate, and said promoter, as follows :

That the undersigned subscribers, each for himself, and not jointly, does hereby subscribe for so much of the preferred stock of said corporation as is set opposite our names upon the terms herein stated, and does hereby agree to pay to said bank in cash the full face value thereof upon — days' notice; when payment is so made, said bank shall issue negotiable receipts therefor, and when ready receive the same in exchange for certificates of stock in said corporation.

With each share of preferred stock subscribed and paid for each subscriber shall receive one full-paid share of common stock of said corporation.

This agreement shall not become obligatory upon any of the parties hereto unless and until preferred stock to the amount of \$—— is underwritten according to the terms hereof, but shall immediately become operative when such amount is so subscribed; said bank shall mail notice of this fact to said subscribers. Said bank shall also have power to enforce this agreement, either by suit upon such subscriptions or by forfeiture of all payments made by parties in default, and may deprive the same of any right to participate in the benefits of this agreement.

It is further agreed that upon delivery by said promoter, or any one for him, of the certificates of stock in said corporation to said bank, the latter is hereby authorized immediately to pay over to said promoter, or as he shall direct, the cash paid in by the subscribers hereto, and said promoter or said corporation shall in no way be or become responsible for the proper distribution of such shares to the subscribers hereto by said bank.

If, for any reason, said promoter shall abandon the project of organizing said corporation, and shall so notify said bank, then this agreement in all its parts shall become inoperative, and all sums paid by said subscribers shall be returned to them.

\_\_\_\_\_, Promoter.  
\_\_\_\_\_, Bank.

SUBSCRIBERS.

Names.	Address.	Number of Shares of Preferred Stock.
_____	_____	_____
_____	_____	_____
_____	_____	_____

\_\_\_\_\_  
FORM XIX.

AGREEMENT BETWEEN THE —— CORPORATION  
AND THE PROMOTER.

This agreement made this —— day of ——, between the —— Company, a corporation organized and existing under the laws of —— (called herein the corporation), and ——, promoter, witnesseth :

Whereas, Said corporation has been organized [describing it and its purpose, as in Form XVII above]. And,

Whereas, Said promoter has entered into contracts with such companies for the purchase of all their stock and property upon certain terms and valuations therein contained, with the power of assignment thereof. And,

Whereas, Said corporation, after careful investigation by its board of directors, has ascertained that the amounts promised to be paid for said stock and property by said promoter is just and reasonable, and not in excess of the real value thereof. And,

Whereas, There will be required \$—— in cash in order to complete said purchase and provide the working capital necessary to the successful operation and management of the properties so proposed to be acquired by said corporation. And,

Whereas, Said promoter, in order to provide said amount of cash, has entered into a contract with the —— syndicate, organized to furnish the same by underwriting and subscribing for the preferred stock of said corporation, upon the terms and conditions therein stated, and particularly to deliver to the —— bank for said syndicate \$—— of the preferred and \$—— of the common stock of this corporation, as a commission for so guaranteeing and furnishing said cash, and also to deliver with each share of preferred stock subscribed and paid for by each member of such syndicate, one full-paid share of common stock. And,

Whereas, Said corporation, being fully advised as to the terms and conditions of all the contracts entered into by said promoter for the purposes therein contained, and which said promoter proposes to assign to said corporation,

Now, therefore, it is hereby agreed by the parties hereto that for and in consideration of the payment by delivery of stock of said corporation hereinafter provided, to be made by said corporation to said promoter, or as he shall direct, he will on or before the —— day of ——, make or cause to be made a transfer of all the property, business and stock of the aforementioned companies by full and sufficient instruments of conveyance thereof, and also will deliver to said corporation the sum of \$—— cash, together with an assignment of all his rights and interests in and to such property under such contracts. And said corporation, in consideration of such transfer and payment by said promoter, or any one for him as above set forth, agrees to pay and deliver to said promoter, or as he shall direct, the sum of \$—— of its preferred and \$—— of its common stock, fully paid, which said promoter shall receive in full payment for such property and stock and for his and all other services in the formation, organizing and financing such corporation; and such corporation hereby ratifies, confirms and adopts all of the terms and provisions of said aforementioned contracts made by such promoter, assumes the same, and agrees to hold harmless said promoter thereunder.

———, Corporation.

———, Promoter.



FORM XX.

UNINCORPORATED TRUST.

See, *supra*, p. 100.

FORM XXI.

PROSPECTUS.

See, *supra*, p. 540.

FORM XXII.

CERTIFICATE OF STOCK.

[COMMON CAPITAL STOCK.]

{ Certificate for  
Less than 100 Shares. }

Number.

\_\_\_\_\_.

{ Certificate for  
Less than 100 Shares. }

Shares.

\_\_\_\_\_.

Incorporated under the Laws

of the State of New Jersey.

UNITED STATES STEEL CORPORATION.

This is to certify that \_\_\_\_\_ is the owner of \_\_\_\_\_ fully paid and non-assessable shares of the par value of one hundred dollars each in the common capital stock of the United States Steel Corporation, transferable only in person or by attorney upon the books of said corporation upon surrender of this certificate. The holders of the preferred stock shall be entitled to receive, when and as declared, from the surplus or net profits of the corporation, yearly dividends at the rate of seven per centum per annum, and no more, payable quarterly on dates to be fixed by the by-laws. The dividends on the preferred stock shall be cumulative, and shall be payable before any dividend on the common stock shall be paid or set apart, so that if in any year dividends amounting to seven per cent. shall not have

Tens.	Units.
1	1
2	2
3	3
4	4
5	5
6	6
7	7
8	8
9	9
0	0

Registered, \_\_\_\_\_,  
 GUARANTY TRUST COMPANY OF NEW YORK, Registrar.  
 By \_\_\_\_\_, Assistant Secretary.

been paid thereon, the deficiency shall be payable before any dividends shall be paid upon or set apart for the common stock. Whenever all cumulative dividends on the preferred stock for all previous years shall have been declared, and shall have become payable, and the accrued quarterly installments for the current year shall have been declared, and the company shall have paid such cumulative dividends for previous years and such accrued quarterly installments, or shall have set aside from its surplus or net profits a sum sufficient for the payment thereof, the board of directors may declare dividends on the common stock payable then or thereafter, out of any remaining surplus or net profits. In the event of any liquidation or dissolution or winding up (whether voluntary or involuntary) of the corporation, the holders of the preferred stock shall be entitled to be paid in full both the par amount of their shares and the unpaid dividends accrued thereon, before any amount shall be paid to the holders of the common stock, and after the payment to the holders of the preferred stock of its par value, and the unpaid accrued dividends thereon, the remaining assets and funds shall be divided and paid to the holders of the common stock according to their respective shares. The preferred stock and the common stock may be increased as provided in the certificate of incorporation. This certificate is not valid without the signatures of the transfer agent and registrar of transfers.

Witness the signatures of the president or of a vice-president, and of the treasurer, or of an assistant treasurer, of said corporation.<sup>1</sup>

\_\_\_\_\_,  
 Assistant Treasurer.

\_\_\_\_\_,  
 Vice-President.

[SHARES \$100 EACH.]

(On the back.)

For value received — hereby sell, assign and transfer unto — — shares of the capital stock represented by the within certificate, and do hereby irrevocably constitute and appoint — attorney to transfer the said stock on the books of the within named corporation, with full power of substitution in the premises.

Dated —, 19—.

In presence of —.

*Notice.* The signature to this assignment must correspond with the name as written upon the face of the certificate in every particular, without alteration or enlargement, or any change whatever.

See, also, *supra*, p. 1695.

<sup>1</sup> *Note.* It will be noticed that these shares are not issued under the corporate seal; it is usual to have the corporate seal affixed to certificates of stock.

By \_\_\_\_\_, Assistant Secretary.  
 HUDSON TRUST COMPANY, Transfer Agent.

(Date.)

## FORM XXIII.

## PREFERRED AND GUARANTEED STOCK.

See, *supra*, pp. 786, 1632, and provisions of the charter of United States Steel Corporation, *supra*, p. 2071, and *infra*, Form XXIV.

## FORM XXIV.

VOTING TRUST.<sup>1</sup>

AGREEMENT DATED FEBRUARY 1, 1897.

This agreement, made in the city of New York this first day of February, 1897, by and between

## PARTIES.

J. P. Morgan & Co. (hereinafter called the "managers"), reorganization managers, under a certain plan and agreement for the reorganization of the Philadelphia and Reading system, dated the fourteenth day of December, 1895, parties of the first part, and J. Pierpont Morgan, Frederic P. Olcott, and Henry N. Paul (hereinafter called the "voting trustees"), parties of the second part.

## PREAMBLE—PURPOSE OF VOTING TRUST.

WHEREAS, Pursuant to the terms and conditions of the said plan and agreement for reorganization, and in order to promote and protect the value of the securities to be held and to be issued by the Reading Company, and as an additional protection to its new general mortgage bonds, the managers have delivered to the voting trustees certificates for fully paid shares of fifty dollars (\$50) each of the capital stock of the Reading Company, as follows, viz: 560,000 shares of the first preferred stock; 840,000 shares of the second preferred stock; 1,398,000 shares of the common stock, which certificates, together with such other similar certificates as hereafter from time to time may be delivered hereunder, are to be held and disposed of by the voting trustees under and pursuant to the terms and conditions hereof.

And, whereas, Such certificates for shares are substantially in the forms hereto annexed, and for all purposes are made a part hereof.

NOW, THEREFORE:

FIRST.—The voting trustees do hereby promise and agree to and with the managers, and to and with each and every holder of any certificate issued as hereinafter provided, that from time to time, upon request, they will cause to be issued to the managers, or upon their order, in respect of all stock received from them, certificates in substantially the following form:

[*New York Certificate.*]

READING COMPANY.

First Preferred Stock Trust Certificate.

THIS IS TO CERTIFY THAT, as hereinafter provided, ——— will be entitled to receive a certificate or certificates for ——— fully paid shares of fifty dollars each in the FIRST PREFERRED capital stock of the READING COMPANY, and in

<sup>1</sup> From the Commercial and Financial Chronicle, vol. 64, pp. 955-6 (May 15, 1897).

the meantime to receive payments equal to the dividends, if any, collected by the undersigned voting trustees upon a like number of such shares standing in their names; and until after the actual delivery of such certificates, the voting trustees shall possess, and shall be entitled to exercise, all rights of every name and nature, including the right to vote, in respect of any and all such stock, it being expressly stipulated that no voting right passes by or under this certificate, or by or under any agreement express or implied.

This certificate is issued under and pursuant to the terms and conditions of a certain agreement dated February 1, 1897, by and between J. P. Morgan & Co., as reorganization managers, and the undersigned voting trustees. No stock certificates shall be due or deliverable hereunder before the first day of January, 1902, nor until the expiration of such further period, if any, as shall elapse before the Reading Company, for two consecutive years, shall have paid 4 per cent. per annum cash dividends on its first preferred stock; but the voting trustees in their discretion may make earlier delivery.

This certificate is transferable only on the books of the voting trustees in New York by the registered holder, either in person or by attorney duly authorized, according to rules established for that purpose by the voting trustees, and on surrender hereof, and until so transferred, the voting trustees may treat the registered holder as owner thereof for all purposes whatsoever, except that delivery of stock certificates hereunder shall not be made without the surrender hereof.

This certificate is not valid unless duly signed by J. P. Morgan & Co., as agents, and also registered by the Central Trust Company, of New York, as registrar in New York.

This certificate may be exchanged in such manner as the voting trustees may prescribe for a similar certificate to be issued by Drexel & Co., in behalf of the voting trustees, and to be registered by the Pennsylvania Company for Insurances on Lives and Granting Annuities.

IN WITNESS WHEREOF, The said voting trustees have caused this certificate to be signed by J. P. Morgan & Co., their duly authorized agents, this — day of —, 189—.

J. PIERPONT MORGAN,  
FREDERIC P. OLCOTT, } *Voting Trustees.*  
HENRY N. PAUL,

By their agents hereunder.

Registered in New York this — day of —, 189—.

CENTRAL TRUST COMPANY OF NEW YORK, *Registrar.*

Ent.

By —.

—, Transfer Clerk.

PROVISIONS RESPECTING TERMINATION OF TRUST—SECOND PREFERRED STOCK  
SUBJECT TO CONVERSION.

SECOND. On the first day of January, 1902, if then the Reading Company for two consecutive years shall have paid 4 per cent. per annum cash dividend on its first preferred stock, and, if not, then so soon as such dividend shall be so paid, and upon surrender of any stock trust certificate then outstanding, the voting trustees will, in accordance with the terms hereof, deliver

therefor corresponding proper certificates of stock of the Reading Company. It is, however, distinctly understood and agreed that at any date the voting trustees may call upon the holders of stock trust certificates to exchange them for certificates of capital stock, and at or after the date so to be specified in any such call they shall deliver stock certificates in exchange therefor; and also that the second preferred stock is subject to the right of the Reading Company, at its option and in such manner as it shall determine, at any time after dividends at the rate of 4 per cent. per annum shall have been paid for two successive years on the first preferred stock, to convert the second preferred stock not exceeding \$42,000,000 at par, one-half into first preferred stock, and one-half into common stock.

**VOTING TRUST TO APPLY TO ANY SUCCESSOR CORPORATION.**

**THIRD.** The term "Reading Company," for the purposes of this agreement and for all rights thereunder, including the issue and delivery of stock, shall be taken to mean either the Pennsylvania corporation of that name, or any successor or consolidation or any corporation which, with the unanimous approval of the voting trustees, shall be adopted to carry into full effect said reorganization plan and agreement, dated December 14, 1895.

**TO INCLUDE ALL STOCK HEREAFTER ISSUED.**

**FOURTH.** From time to time hereafter the voting trustees may receive any additional fully paid stock, duly authorized, of the capital stock of the Reading Company, either preferred or common, and in respect of all such stock so received, will issue and deliver certificates similar to those above mentioned, entitling the holders to all rights above specified.

**RESIGNATION AND APPOINTMENT OF VOTING TRUSTEES.**

**FIFTH.** Any voting trustee may, at any time, resign by delivering to the other voting trustees, in writing, his resignation, to take effect ten days thereafter; and in every case of death or resignation, or of the inability of any voting trustee to act, the vacancy so occurring shall be filled by the appointment of a successor or successors, to be made by the other voting trustees by a written instrument, and the term "voting trustees," as herein used, shall apply to the parties of the second part and their successors hereunder.

**LIMITATIONS ON POWERS OF VOTING TRUSTEES.**

**SIXTH.** All questions arising between the voting trustees shall from time to time be determined by the decision of the greater number of those then acting as voting trustees, either at a meeting, or by writing with or without meeting, and in like manner they may establish their rules of action, but they will not, nor will any of them, consent that (1) any mortgage, additional to the mortgage of \$135,000,000 heretofore authorized, shall hereafter be put upon the property formerly constituting the system of the Philadelphia and Reading Railroad Company and Philadelphia and Reading Coal and Iron Company, or that (2) the amount of the first preferred stock of the Reading Company may be increased, except after they shall, in each instance, have obtained the consent of the holders of a majority of the whole amount of each class of preferred stock trust certificates given at a meeting of such certificate holders called for that purpose, and also the consent of the holders of

a majority of such part of the common stock trust certificates as shall be represented at such meeting; the holders of each class of stock trust certificates voting separately; or that (3) the amount of the second preferred stock be increased except with like consent by the holders of a majority of the whole amount of second preferred stock trust certificates given at a meeting of the holders of second preferred stock certificates called for that purpose, and also with like consent by the holders of a majority of such part of the common stock trust certificates as shall be represented at such meeting; the holders of each class of stock trust certificates voting separately; *provided, however*, that no consent of holders of stock trust certificates shall be required or necessary to authorize the voting trustees to consent or the company to proceed to the conversion of its second preferred stock to an amount not exceeding \$42,000,000 at par, one-half into first preferred stock and one-half into common stock, at any time after dividends at the rate of 4 per cent. per annum shall have been paid for two successive years on the first preferred stock.

VOTING TRUSTEES TO SELECT SUITABLE DIRECTORS.

SEVENTH. In voting the stock held by them, the voting trustees will exercise their best judgment from time to time to select suitable directors, to the end that in accordance with the purposes first above set forth the affairs of the company shall be properly managed; and in voting on other matters which may come before them at any stockholders' meeting, they will exercise like judgment; but they assume no responsibility in respect to such management, or in respect of any action taken pursuant to their votes so cast, it being understood that no voting trustee incurs any responsibility for the act or omission of any agent hereunder, nor by reason of any error of law or of any matter or thing done or omitted under this agreement, except for his own individual malfeasance.

EIGHTH. This agreement may be simultaneously executed in several counterparts, each of which so executed shall be deemed to be an original, and such counterparts shall together constitute but one and the same instrument. Any voting trustee hereunder may vote in person or by proxy to any other person, whether or not a voting trustee.

IN WITNESS WHEREOF, The several parties hereunto have set their hands and seals the day and year first above mentioned.

Signed by J. P. Morgan & Co. and the three voting trustees, viz: J. P. Morgan, F. P. Olcott, H. N. Paul.

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FORM XXV.

CORPORATE NOTES, SIGNATURES AND ACKNOWLEDGMENTS.

See, *supra*, pp. 862, 863, 864, 1138, 1142, 1145 and 1150.





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